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The Forward View: Global Feb 2023

Inflation is slowing but is still yet to be tamed

NAB Group Economics

Overview

- Global inflation data showed the slowing trend in consumer price growth continued in December. That said, while it appears that global price growth may now be past its peaks, inflation in the US, UK and France remained stable in January and, more generally, inflation remains well above targets set by global central banks. This means that there is scope for further policy rate hikes in coming months.
- It remains to be seen what impact China's reopening will have on inflationary pressures. While Chinese demand may rise (supported by accumulated savings), this may be offset by the further easing of supply constraints – from the removal of COVID-19 restrictions and the recovery from the rapid spread of the virus in December.
- Outside the US, economic growth across the major advanced economies (AEs) was subdued in the final quarter of 2022 but the outright declines expected for the UK and Euro-zone were avoided (and we no longer expect the latter to contract in Q1). Business surveys, which trended down through much of 2022, have stabilised with signs of upwards momentum on the services side. While there has been a boost from falling energy prices and the end of China's zero-COVID policy, the outlook remains weak as monetary policy continues to tighten.
- Anecdotal evidence suggests China's rebound appears to be more rapid than we had expected. Following the abandonment of the zero-COVID policy, we had anticipated a disruptive transitional period across most of Q1 2023. Instead, it appears that most of the impact occurred between mid-December and mid-January, with subway passenger movement and traffic congestion pointing to a pickup in activity post the Chinese New Year holidays.
- Our global forecasts are stronger this month, reflecting an improved short-term outlook for major advanced economies and the faster-than-anticipated recovery in China. That said, the improvement should not be over-stated. Overall, we now forecast the global economy to expand by 2.6% in 2023 (previously 2.3%) – down from 3.4% in 2022. Outside the Global Financial Crisis and COVID-19, this would represent the weakest rate of growth since 2001. Our outlook for 2024 is unchanged at 2.8%. This is below the long run average of 3.4% yoy (recorded between 1980 & 2021).

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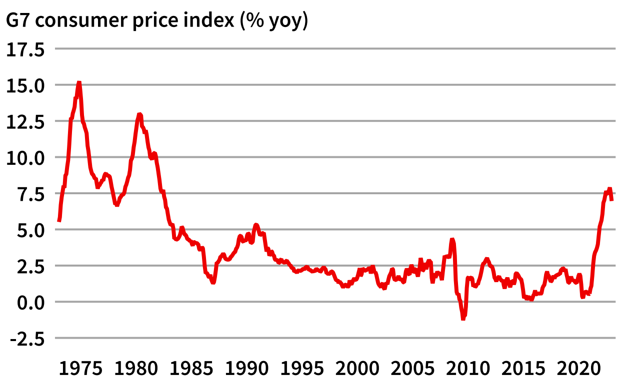
Global growth forecasts

	2020	2021	2022	2023	2024
US	-2.8	5.9	2.1	0.7	1.0
Euro-zone	-6.3	5.3	3.5	0.8	0.8
Japan	-4.3	2.2	1.5	1.0	0.8
UK	-11.0	7.6	4.0	-0.3	0.7
Canada	-5.1	5.0	3.6	1.0	1.0
China	2.2	8.1	3.0	5.4	4.5
India	-6.6	8.3	7.1	5.0	6.0
Latin America	-7.0	6.4	3.4	0.9	1.3
Other East Asia	-2.8	4.4	4.2	2.7	3.7
Australia	-1.8	5.2	3.7	1.7	0.6
NZ	-1.4	6.1	2.8	1.2	0.3
Global	**-3.0**	**6.2**	**3.4**	**2.6**	**2.8**

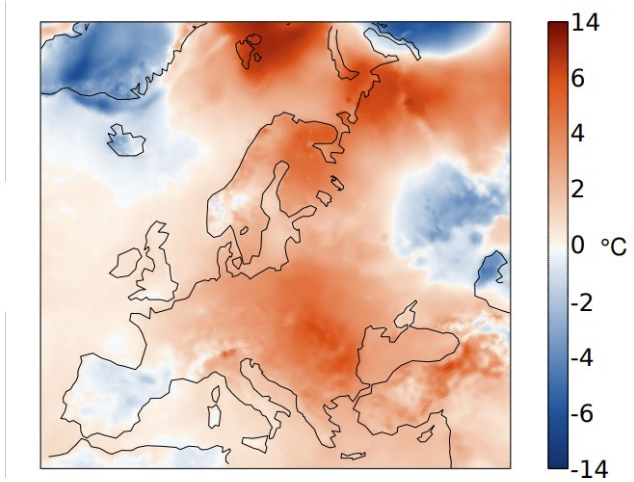
Inflation in major advanced economies is gradually easing from multi-decade highs



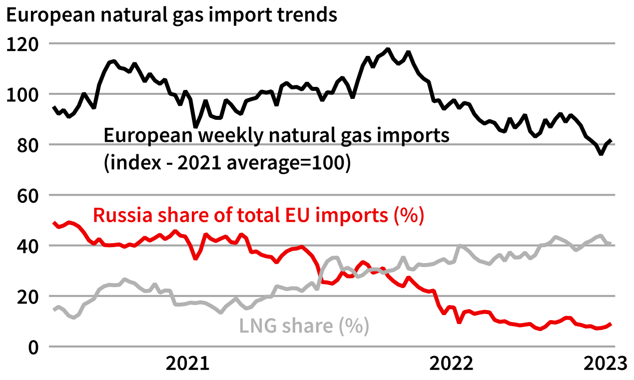
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: Warmer than average temperatures in Europe over winter have helped contain gas-related energy price shock

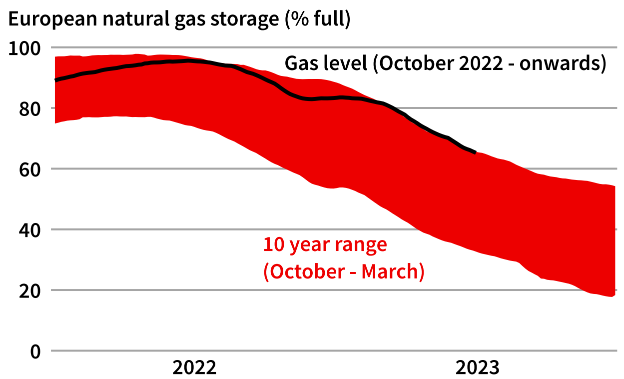
Most of mainland Europe saw warm-than-average weather in January, reducing natural gas demand for heating purposes…



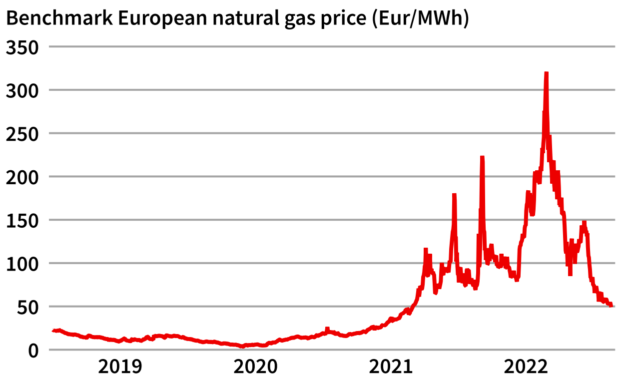
…which despite lower total natural gas imports (and, in particular, steep declines in imports from the Russian Federation)…



…meant that natural gas storage levels remained near the upper bound of historical levels for the heating season over the past ten years.



This allowed gas prices to retreat from a recent cycle price spike to near €50/MWh in mid-February, limiting economic damage from an energy price shock



But the near term positive could soon become negative

It is worth noting that low levels of snowfall across Europe this winter could negatively impact a range of sectors by the northern summer. Lower water levels (from reduced snow melt) could affect regional agriculture, limit the usage of a range of electricity generation (as higher water temperatures reduce its ability to provide necessary cooling) and could constrain the use of major waterways for goods transport.

Sources: Copernicus Climate Change Service/ECMWF, Bruegel, Gas Infrastructure Europe, Macrobond, NAB Group Economics

Financial and commodity markets: central banks slow rate rises, but inflation is not yet tamed

Global inflation data are broadly available to December 2022 and continue to show a slowing trend in consumer price growth. Global consumer prices rose by around 8.4% yoy in December, slowing from a peak of around 9.6% yoy in September. That said, while it appears that global price growth may now be past its peaks, data from the United States, United Kingdom and France showed inflation remaining stable in January and, more generally, inflation remains well above targets set by global central banks. This means that there is scope for further policy rate hikes in coming months.

That said, central banks are reducing the size of rate rises, attempting to minimise the risk of over-tightening. The US Federal Reserve lifted rates by 25 basis points at its February meeting – compared with four consecutive 75 basis point increases that were followed by a 50 basis point rise last year. We anticipate two additional 25 bp hikes from the Fed (among others) in coming months.

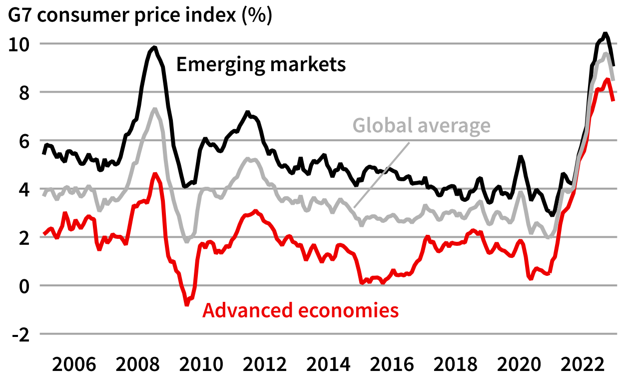
It remains to be seen what impact China's reopening will have on inflationary pressures. Given that zero-COVID policies constrained consumption and savings rose (particularly in late 2023), it is likely that consumer demand will increase. That said, the further easing of supply constraints – from the removal of COVID-19 restrictions and the recovery from the virus's rapid spread in December – may offset stronger domestic demand. China's producer prices fell again in January – down by 0.8% yoy – the fourth straight month of falls.

Financial market volatility has eased in recent weeks, when compared with recent cycle peaks in October. Measures such as the MOVE index (measuring bond market volatility) and the VIX index (equities) have trended lower, albeit they remain above pre-pandemic levels.

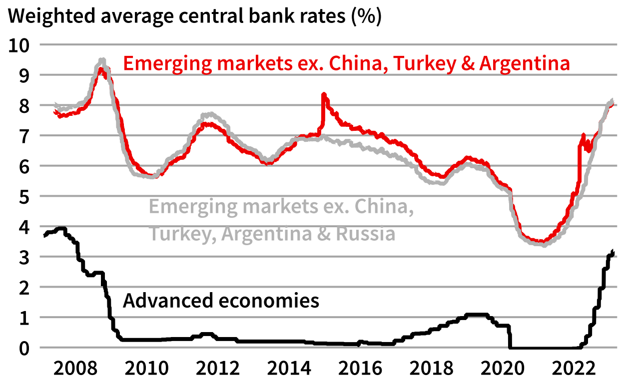
Equity market indices have generally trended higher since mid-October, reversing a downward trend since late 2021 (for US markets) and mid-2021 (for non-US advanced economies and emerging markets). That said, these markets remain well below their peaks.

Commodity prices have largely tracked sideways since September 2022, with the aggregate S&P GSCI index stabilising at a relatively high level (when compared with pre-pandemic levels). The energy component of the index has retreated considerably since June 2022 – with natural gas recording the largest decline. It remains to be seen whether energy prices will continue to fall, following Russia's announced 500 000 barrel a day cut to production starting in March (equivalent to around 5% of its output). This came in response to a range of advanced economies attempting to impose a price cap on Russian crude oil. In addition, Chinese energy demand is likely to rise following its reopening.

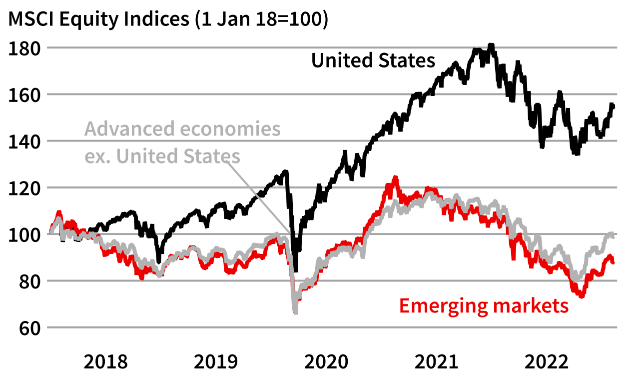
Consumer price growth peaked but remains high…



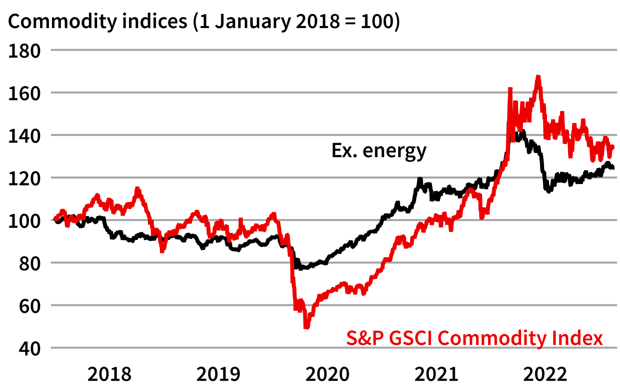
…providing scope for further policy rate rises



China reopening supporting equity recovery



Commodity prices have tracked broadly sideways



Advanced economies: Euro-zone & UK avoid Q4 falls; AE outlook still weaker but has brightened

Outside the US, economic growth across the major advanced economies (AEs) was subdued in the final quarter of 2022 but the outright declines expected for the UK and Euro-zone were avoided.

The US posted solid 0.7% q/q growth in Q4, albeit in part due to a large inventory contribution. Domestic final demand growth was much weaker (0.2% q/q). While some indicators declined at the end of 2022, initial January data has been much stronger. Retail sales and manufacturing have rebounded strongly, employment growth accelerated and the December plunge in the services ISM was reversed. While this may reflect weather impacts, it may also point to greater underlying strength and suggests there is upside risk to our US forecast.

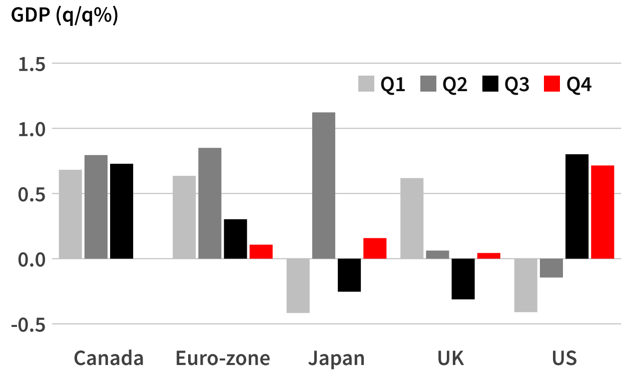
Our December forecasts allowed for declines in UK and Euro-zone GDP in Q4. In the event, the Euro-zone managed to eke out growth of 0.1% q/q and it was even more marginal in the UK. Conditions across the Euro-zone were mixed – with German and Italian GDP falling, but France and Spain up. Moreover, the recent upturn in the PMIs suggests that the Euro-zone is more likely to grow in Q1 than not. More fundamentally, the substantial decline in energy prices is providing an income boost to the region. Accordingly, we no longer expect a contraction in Q2 GDP, but still see only a modest growth outlook as monetary policy tightens further.

However, UK GDP remains below where it was in Q1 2022 and December month activity tumbled (-0.5% m/m) pointing to weakness re-emerging towards quarter-end. While we have revised up our forecast for 2023, due to the better than expected Q4 result, we still expect that GDP growth will contract in H1 2023.

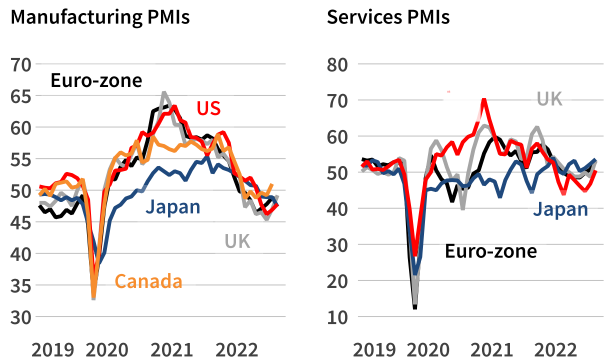
Japanese GDP growth again disappointed, failing to fully reverse the Q3 fall. This partly reflects a negative contribution from stocks and domestic final demand has grown over this period. Like Europe, as a net energy importer, Japan will benefit from the recent large decline in energy prices. On the flipside, the rotation of global demand towards services, reinforced by the rebuilding of inventories that has occurred, may weigh on Japanese manufacturers. There was a substantial decline in export volumes over December-January, although Chinese New Year holiday distortions may be a factor.

Business surveys had been pointing to a weak in growth but the latest data (including February data released overnight) suggest a pause in the downwards trend seen over 2022, if not some upwards momentum on the services side. The fall in energy prices and China's move away from its zero-COVID approach have provided a timely boost for the outlook. However, inflation remains high, labour markets are very tight and resilience in activity can cause central banks to raise rates higher. A period of negative to weak growth remains in prospect.

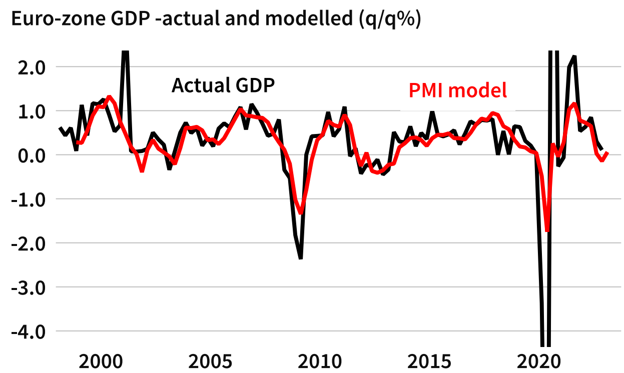
Euro-zone and UK avoid contraction in Q4



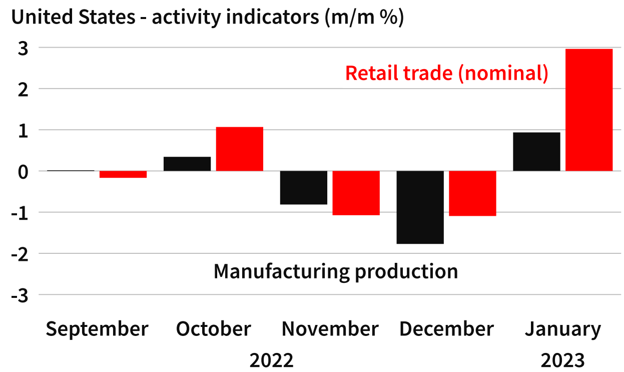
Surveys still weak but have stabilised



Euro-zone looks to have avoided recession



US – January data surprises; noise or signal?



Emerging markets: the end of zero-COVID supports China's recovery, but headwinds remain

Emerging market business surveys improved in January, as positive signs around China's economic recovery, after abandoning its zero-COVID policies, provided support. The EM composite PMI rose to 51.9 points in January (from 50.1 points in December and negative readings in October and November).

This strengthening was driven by the services sector. The EM services PMI rose to 53.1 points in January (up from 50.1 points previously). China was the key driver of this upturn, while the services reading for Russia was marginally less negative.

Anecdotal evidence suggests China's rebound appears to be more rapid than we had expected. Following the abandonment of the zero-COVID policy, we had anticipated a disruptive transitional period across most of Q1 2023. Instead, it appears that most of the impact occurred between mid-December and mid-January, with subway passenger movement and traffic congestion pointing to a pickup in activity post the Chinese New Year holidays.

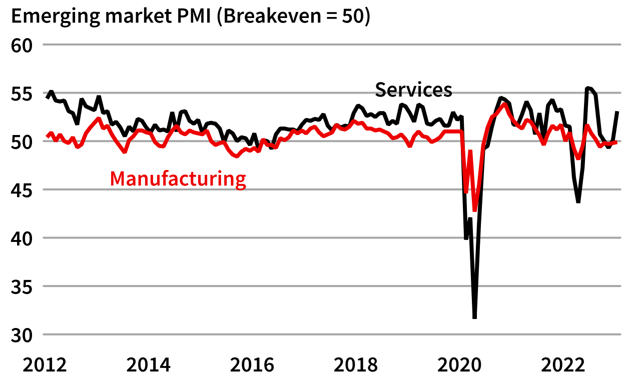
In contrast, the EM manufacturing PMI was only marginally improved in January – at 49.9 points (from 49.8 points previously). China's manufacturing sector had been better placed than services to operate under zero-COVID conditions, and combined with the weaker prospects for demand in advanced economies in 2023, this meant there was less of an impact from the policy easing.

Emerging markets are generally more trade dependent than advanced economies, with weaker AE demand a key headwind to EM growth in the near term. Global trade data are available to November 2022 and show a sharp slowing in export volumes from emerging markets, particularly from October onwards. In a large part, this reflects the impact of tightening monetary policy on demand in most advanced economies.

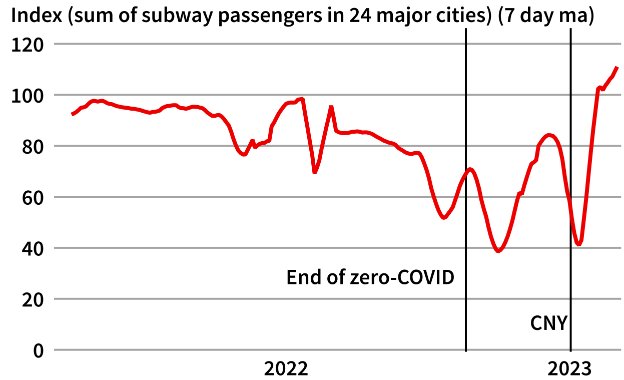
China's reopening has appeared to restore the confidence of international investors. Capital flowed out of China for the majority of 2022, primarily as global funds exited China's bond market. In contrast, there were notable inflows into China's equity market in November and December, before a surge in January, as signs of the more rapid-than-expected recovery started to emerge.

Optimism regarding China's recovery should be tempered by remaining headwinds – most notably the property sector. New construction starts fell by over 39% in 2022, and despite policy measures to shore up the sector, low confidence among Chinese property buyers (following the collapse of Evergrande, the litany of undelivered projects and last year's mortgage strike) could constrain activity. Similarly, there is no guarantee that Chinese consumers will unleash built up savings in a "revenge spending" spree.

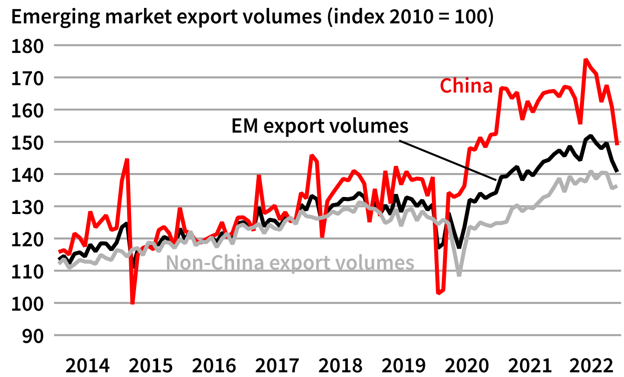
End of zero-COVID sent EM services soaring in January



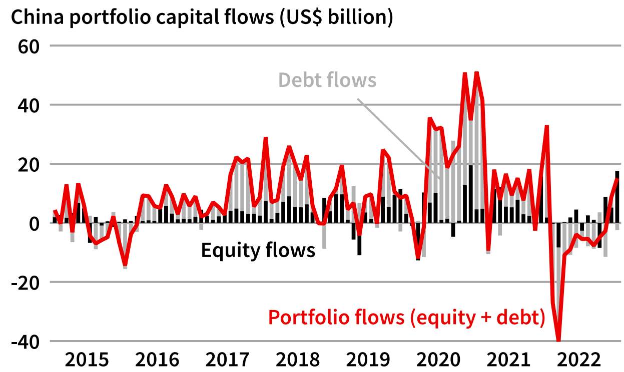
China subway usage points to rapid rebound



Weaker AE demand hitting EM export volumes



Surge in capital inflows into China in January



Sources: Macrobond, IIF, NAB Group Economics

Global forecasts and risks: our outlook is less negative, but growth is below long run average

Global business surveys improved somewhat in January, with the JP Morgan global composite PMI moving closer to neutral levels at 49.8 points (from 48.2 points in December). The China-led upturn in EM services was a key driver of this move, with advanced economies PMIs remaining in negative territory.

The impact from a normalisation in spending to services, higher inventory levels and tighter monetary policy on demand in advanced economies suggests weaker prospects for global manufacturers in 2023. Global export volumes fell by 1.6% yoy in November, the first decline since COVID-19 disruptions in 2020.

Our global forecasts are stronger this month, reflecting an improved short-term outlook for major advanced economies and the faster-than-anticipated recovery in China. That said, the improvement should not be over-stated. Overall, we now forecast the global economy to expand by 2.6% in 2023 (previously 2.3%) – down from 3.4% in 2022. Outside the Global Financial Crisis and COVID-19, this would represent the weakest rate of growth since 2001. Our outlook for 2024 is unchanged at 2.8%. This is below the long run average of 3.4% yoy (recorded between 1980 and 2021).

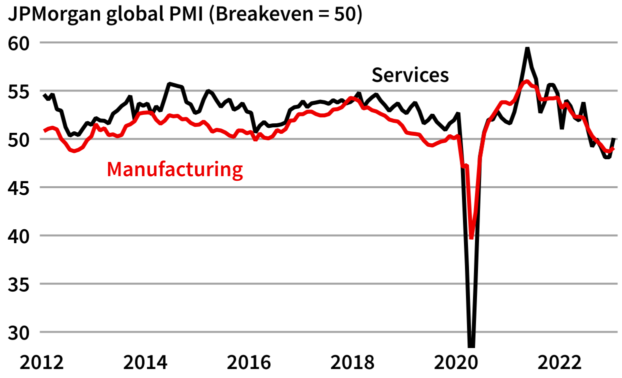
Better than expected outcomes for Q4 have contributed to upward revisions to the 2023 forecast for the US, UK and Euro-zone, but now expect 2024 AE growth to be a bit weaker. The Euro-zone and UK are also being boosted by the falls in energy prices over winter, while January data to-date point to upside risk to our US forecast.

We are forecasting China's economy to expand by 5.4% in 2023, though there could be some upside risk. Much will depend on the confidence of consumers to spend, which could be negatively impacted if the country experiences further COVID-19 waves.

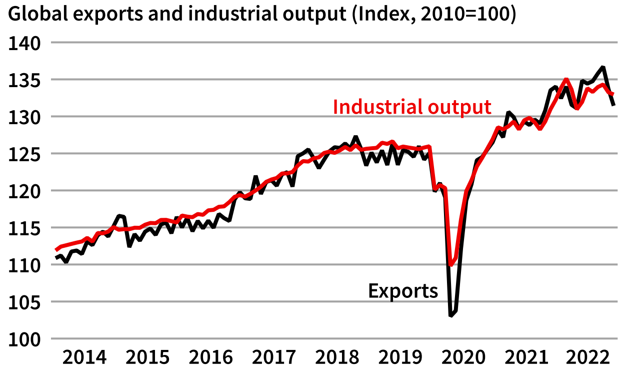
We have also revised up our forecast for Russia – which is now expected to record no growth in 2023, rather than contracting. Sanctions on the country, following the invasion of Ukraine, have not been as impactful as anticipated, with Russia continuing to find export markets (primarily for its energy commodities).

There remain a number of risk factors that cloud our global outlook. There remains no resolution to the Russia-Ukraine conflict – which has now persisted for a full year – contributing to supply disruptions in energy, grains and fertiliser markets. Inflation has persisted for considerably longer than most central banks anticipated – as highlighted by the stickiness of US inflation in January – increasing the risk of tighter than expected monetary policy to curb inflation (and with it, weaker growth). Geo-political tensions have also persisted – most notably between the US and China, following the shooting down of a Chinese spy balloon.

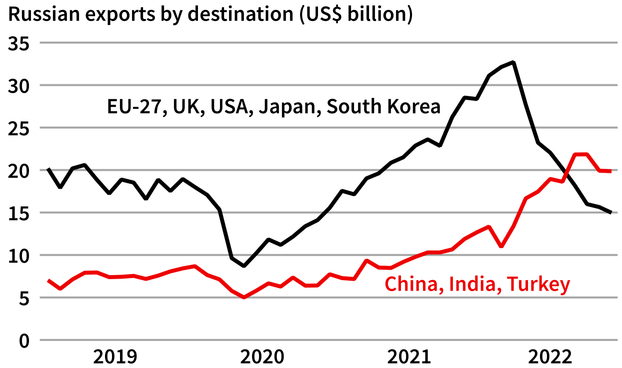
Services the key driver of less negative global PMI



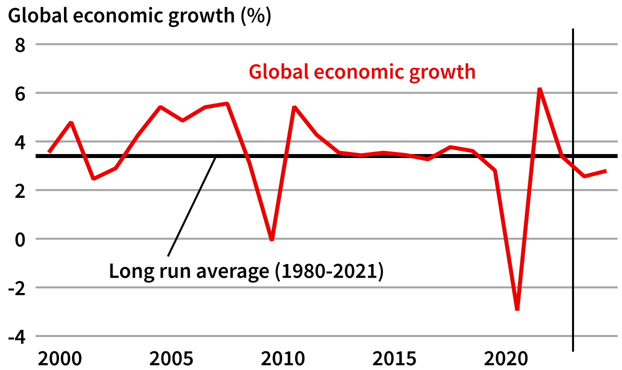
Prospects for global manufacturing weaker in 2023



Limited impact from sanctions on Russian exports



Global growth below long run average in 2023 and 2024



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