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The Forward View: Global April 2023

Bounce in global growth in Q1 won't last

NAB Group Economics

Overview

- Banking stress in the US and Europe has been contained by the swift actions of regulators in both regions. Financial market volatility has eased and equity markets (including bank stocks) have strengthened. In the US, use of the Federal Reserve's funding facilities is slowly normalising and bank lending has stabilised.
- However, there is still likely to be fallout from the March 2023 banking stress, with lending standards expected to tighten further. This has contributed to a pull-back in expectations of central bank rate rises. While some further rate hikes are expected – in particular, by the ECB and the Fed – the peak of the global tightening cycle is in sight.
- Whether this ends up being the case, and how long rates are kept at elevated levels, will depend on the path for inflation. Global inflation data continue to suggest a gradual easing from the peak rates of late 2022. The lagged effects of an easing in supply chain problems and the impact of policy tightening on demand, should see inflation decline further but oil producers have moved to put a floor under oil prices and core inflation is proving sticky.
- Global GDP growth looks to have bounced higher in Q1 2023. This largely reflects the impact of China's abandonment of zero-COVID, with China's economy growing 2.2% q/q in Q1. The US economy is also on track to record solid growth in the quarter, while the Euro-zone and UK also set grow, helped by the unwinding of the last year's energy price shock.
- However, China will not be able to sustain growth at its Q1 pace, and with the impact of tighter policy settings (including fiscal) still working its way through, global growth over the rest of 2023 is likely to be more subdued. We continue to anticipate that annual average global growth will step down in 2023 and 2024 – to around 2.7%. Excluding the downturns associated with the global financial crisis and COVID-19 impacted 2020, these would be the slowest rates of growth since 2001. A modest recovery is likely in 2025.

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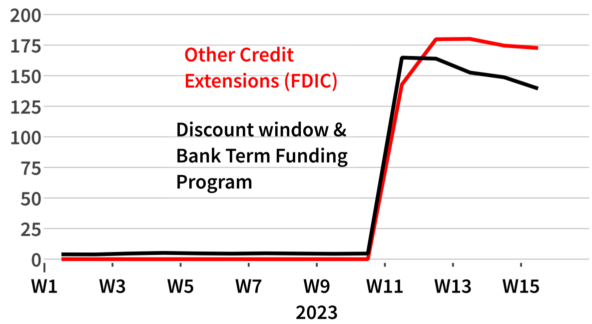
Global growth forecasts

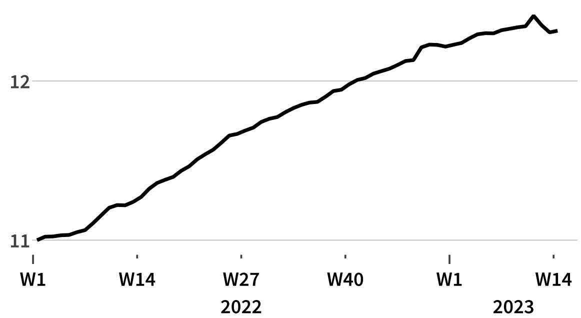
	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.1	0.9	1.9
Euro-zone	-6.3	5.3	3.5	0.9	0.7	1.2
Japan	-4.3	2.2	1.5	0.8	0.6	0.8
UK	-11.0	7.6	4.1	0.2	0.6	0.9
Canada	-5.1	5.0	3.4	1.1	1.0	1.4
China	2.2	8.1	3.0	5.6	4.5	4.8
India	-6.0	8.9	6.7	5.0	6.0	6.3
Latin America	-6.8	7.0	4.0	0.8	1.3	1.8
Other East Asia	-2.8	4.4	4.2	2.7	3.7	4.3
Australia	-1.8	5.2	3.7	1.5	0.9	2.0
NZ	-1.5	6.0	2.4	0.6	0.2	2.3
Global	-2.8	6.3	3.4	2.7	2.7	3.2

US banking problems have been contained – use of Fed facilities easing and bank lending stabilising

Use of Fed facilities ($b, s.a.)



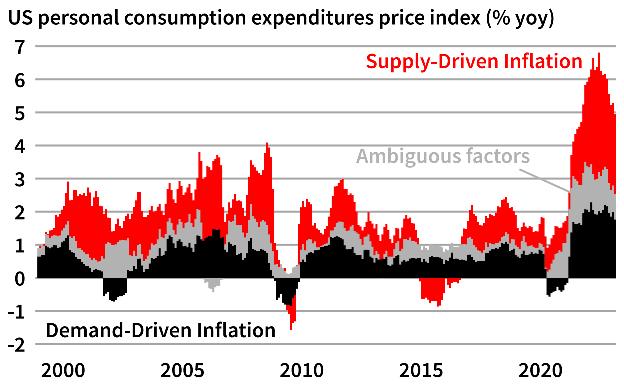
US commercial bank loans and leases ($ trillion, s.a.)



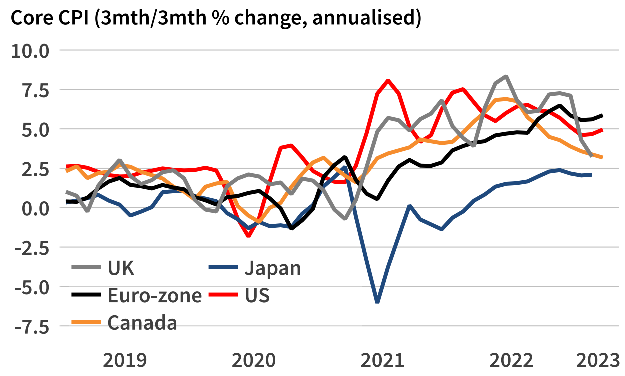
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: while consumer prices have retreated from multi-decade highs, inflation has persisted at comparatively strong rates. While supply side pressures appear to have eased, demand-driven inflation has held up stronger than central banks have anticipated

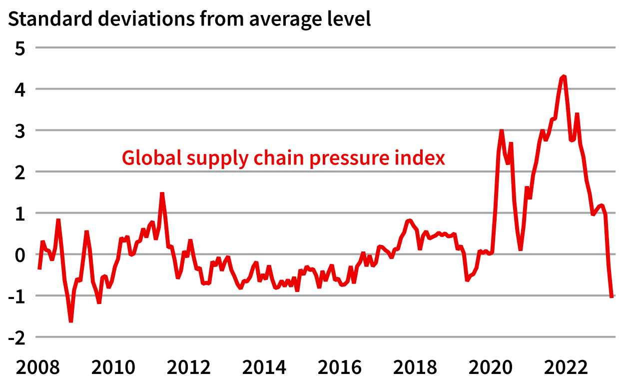
Inflation has remained sticky in much of the advanced world, driven by a complex range of factors on both the demand and supply side



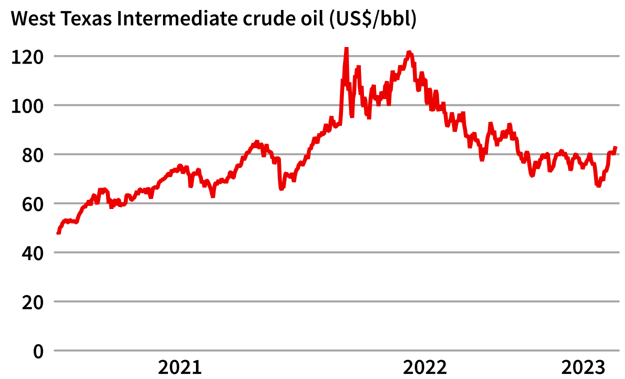
Core inflation is proving sticky – still at around its peak in Euro-zone and Japan while only down modestly in US



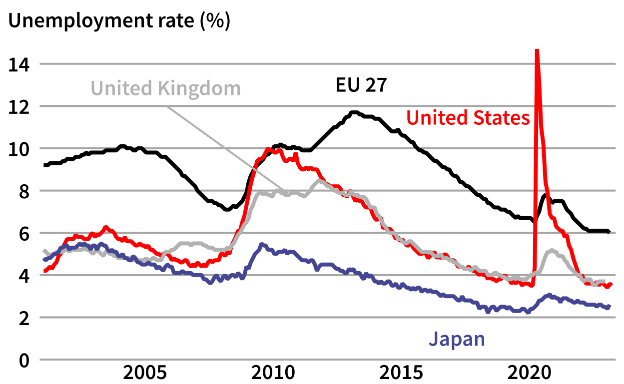
Supply side pressures easing – as long running supply chain disruptions triggered by COVID-19 appear finally resolved…



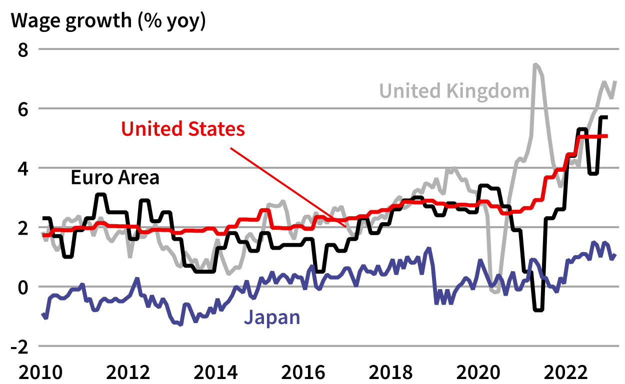
…but major oil producers – such as OPEC+ - are seeking to put a floor under oil prices, which pushed back above US$80 a barrel following announced production cuts



Labour markets remain historically tight in most advanced economies, continuing to provide support for demand…



…with stronger wages growth a possible explanation for sticky core inflation and, as a result, a focus of central banks



Sources: Macrobond, Refinitiv, NAB Group Economics

Financial and commodity markets: banking fears retreat but lending conditions are tightening

For now, concerns around the stability of the banking sector in the United States and Europe – following several bank failures in March – appear to have eased. The key factors that contributed to these failures appear to have been idiosyncratic to these institutions, rather than representative of broader structural issues. The swift actions of regulators in both regions also seem to have cooled fears of financial contagion.

Measures of financial market volatility – such as the MOVE index (which covers bond markets) and the VIX (equity markets) – have eased since their mid-March peak, albeit the MOVE index remains at elevated levels (well above the post-Global Financial Crisis trend). Similarly, equity market trends have strengthened, with aggregated indices rising across regions, US bank stocks stabilising since mid-March and European stocks trending higher (albeit remaining below their early March levels.

That said, risks in the sector have not been eliminated. Overall, deposits in the US commercial banking sector have fallen since early 2022, in part as individuals have sought higher returns elsewhere, most notably money market funds. Smaller banks have been more vulnerable – losing deposits to larger competitors.

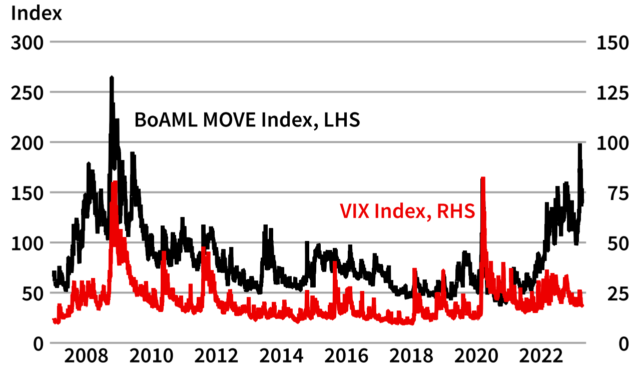
The best case scenario is still likely to see banks and other financial institutions continuing to tighten lending standards and exhibit more caution regarding counterparty risk in interbank markets. The Dallas Fed's Banking Conditions Survey showed a sharp downturn in lending volumes and a tightening in lending standards in early April. This may provide enough tightening to broader financial conditions to slow economic activity and limit the upside risk to central bank policy rates.

Global inflation data to February 2023 continue to suggest a gradual easing from the peak rates of late 2022. We estimate global consumer prices rose by 8.0% in February, compared with 8.4% in January. Month-on-month inflation rates among large advanced economies continue to trend lower, and measures of supply chain disruptions have improved significantly, suggesting that consumer prices should continue to slow in coming months, although core inflation measures are proving sticky.

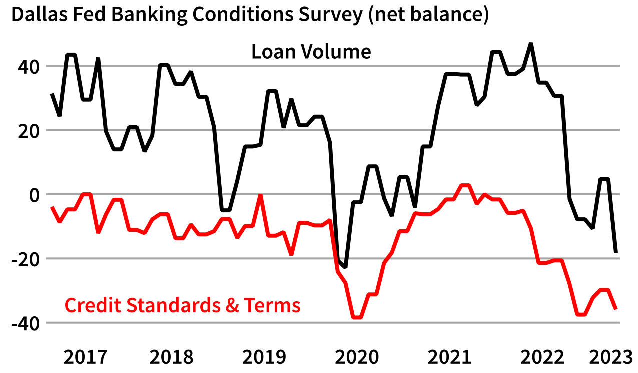
Growth in producer prices has slowed more significantly – with our global estimate down from double digit rates as recently as November 2022 to around 6.3% yoy in February. China's producer prices have contracted year-on-year since October, but there has been a sharp deceleration outside China over the same period.

From mid-March onwards, commodity prices – as measured by the aggregate S&P GSCI index – trended higher, up around 9% in mid-April (back near the levels at the start of March). Energy markets were the key drivers of this trend, in part related to oil production cuts announced by OPEC+ members.

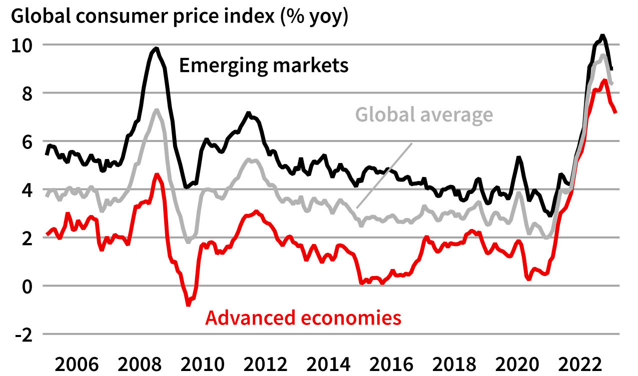
Financial mkt volatility eased slightly since mid-March



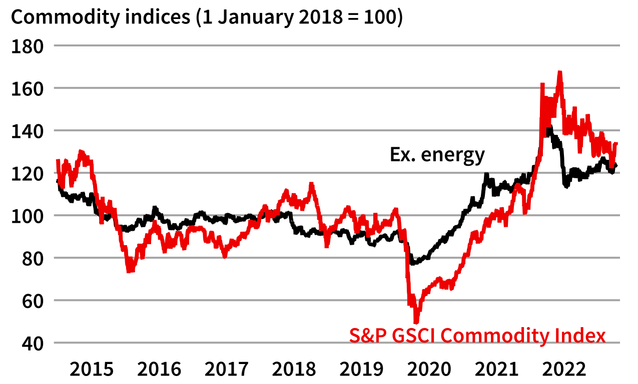
Surveys point to tighter bank policies and lending



Inflation continues to ease (but remains high)



Energy pushes commodities up from mid-March lows



Advanced economies: 2023 crosswinds point to weak AE growth

We expect each of the major advanced economies (AEs) to record GDP growth in Q1, but the outlook beyond this remains weak, and we still expect a downturn in the US.

At the time of writing, the Atlanta Fed's GDP nowcaster (GDPNow) predicts 2.5% q/q annualised growth in US Q1 GDP, suggesting some upside risk to our forecast (1.7%). Monthly UK and Canada GDP estimates (to February) show both economies growing in early 2023. The UK growth defies expectations of a fall in Q1 GDP and, as a result, we have revised up our UK growth forecast.

We also expect Japan to see some rebound in Q1, although data to-date are mixed. The fall in large manufacturer's conditions reported in the Bank of Japan's quarterly Tankan survey in the past has been consistent with a fall in GDP and industrial production is tracking below its Q4 level. However, machinery orders are up, household consumption is rising, and service sector activity indicators have strengthened.

In the Euro-zone, retail sales declined in February but this may simply reflect a continuation of the switch to services consumption. In contrast, manufacturing industrial production grew strongly in February and the Euro-zone composite PMI improved through Q1, consistent with positive GDP growth.

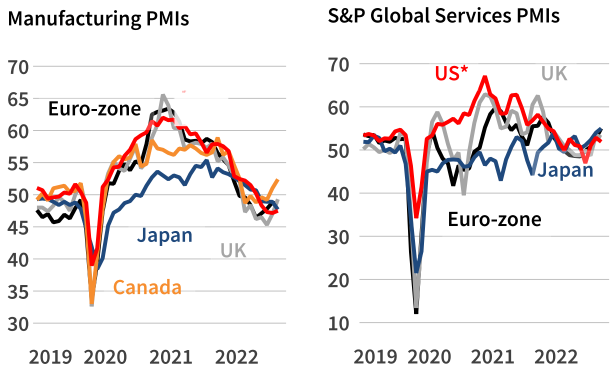
The improvement in the Euro-zone composite PMI in Q1 was driven by the services sector, as was the case for the other major AEs, although the UK and US (ISM & S&P Global average) declined in March. Manufacturing PMIs have stabilised but remain weak.

Europe and Japan are benefiting from the reduction in energy prices that started in H2 2022, unwinding the negative hit to national income from last year's energy shock. For Canada, as a commodity exporter, it represents a fall in the terms of trade. The US is in between, but consumers have benefited from lower gasoline prices. The rebound underway in China is also a positive.

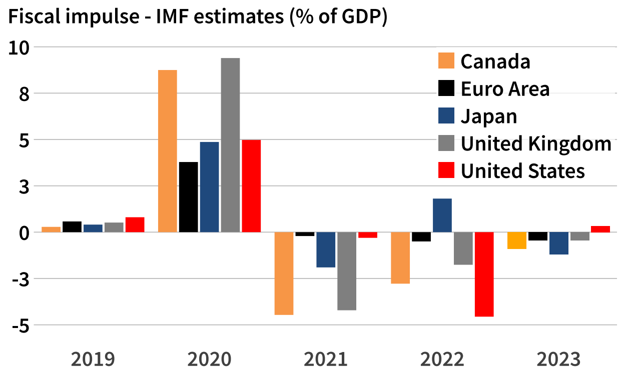
However, headwinds remain. In particular, the full impact of monetary policy tightening is yet to be felt. The March US and European banking problems are also likely to lead to reduced credit availability. Fiscal policy also remains a headwind. While IMF projections suggest the US might be an exception, with a positive fiscal impulse for 2023, looming debt ceiling/budget fights are likely to be destabilising. Households absorbed last year's cost of living pressures by, in part, reducing savings rates – however, outside of Japan, the savings rate is now increasing which may signal growing household caution.

As a result, we are bearish on the outlook, and still expect the US economy to contract at some point this year. For Europe and Japan the cross winds from policy tightening but energy relief are likely to lead subdued growth.

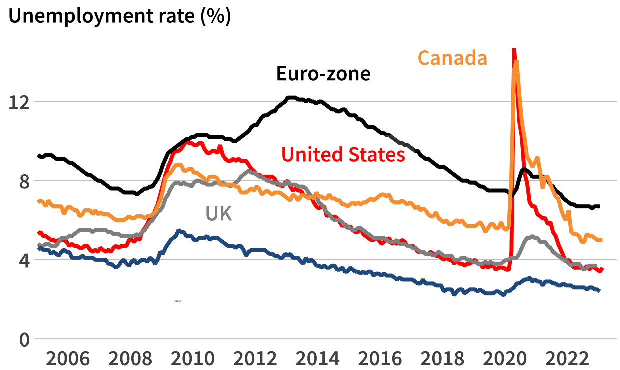
Service sector activity lifted in Q1 2023



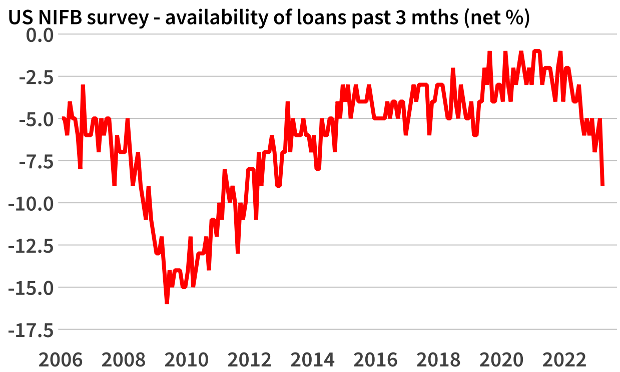
Fiscal headwinds to remain in 2023 but have faded



Savings rates look to have troughed



Watching for spillovers from banking issues – less access to credit likely one consequence



Emerging markets: strong survey readings mask imbalance in China-led recovery

Business surveys provide some of the most up-to-date indicators of conditions in emerging markets. Overall, the EM composite PMI rose to an extremely strong 54.6 points (from 53.9 points previously), however there was significant divergence in the underlying measures.

The key driver of this pickup was the EM services PMI – which rose to 56.7 points (from 54.5 points in February). Continuing the trend exhibited in recent months, China was the key driver of this increase – up to 57.8 points in March (from 55.0 points previously) – along with a stronger outcome in Russia (following a period of negative readings between October 2022 and January 2023).

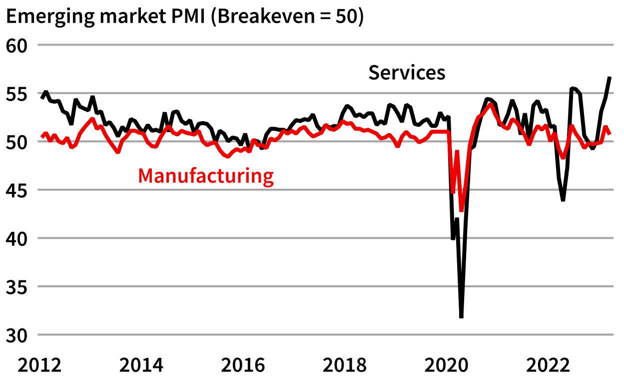
Anecdotal evidence from China suggests that domestic goods consumption remains comparatively subdued, while there has been a recovery in consumer services (which were heavily impacted by zero-COVID policies). That said, the official NBS PMI suggests that construction services activity – linked to infrastructure – has increased more strongly than consumer services.

In contrast, the EM manufacturing PMI eased marginally – down to 50.7 points (from 51.6 points in February). Once again China was the main driver, with a stronger result in India offset by a weaker reading for Brazil. China's manufacturing sector had been operating with limited impact from zero-COVID measures in late 2022, meaning there was less opportunity for a strong rebound in the sector as these policies were abandoned. Prospects for global manufacturers remain comparatively subdued in the near term, as advanced economy goods demand remains weak.

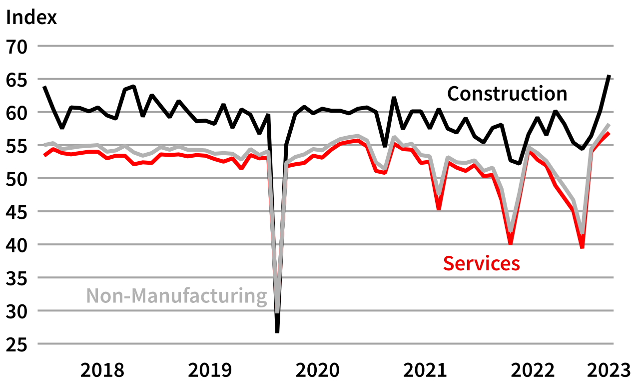
When compared with advanced economies, emerging market growth is generally more dependent on trade activity. Demand for goods in advanced economies has softened since mid-2022, as tighter monetary policy, rising inventory levels and a shift back towards services consumption has begun to bite. Global trade data are available to January, and show an accelerating decline in emerging market export volumes – down by 4.5% yoy (on a three month moving average basis). EM export volumes peaked in June 2022 and have subsequently fallen.

China's economy grew by 4.5% yoy in Q1 2023, reflecting the faster than anticipated transition period following the end of zero-COVID policies, as well as support from base effects (with the end of Q1 2022 marking the start of the COVID-19 wave that would heavily impact the following quarter). The services sector – which was more negatively impacted by zero-COVID than elsewhere – led the rebound, with manufacturing and construction growing marginally more slowly than late 2022.

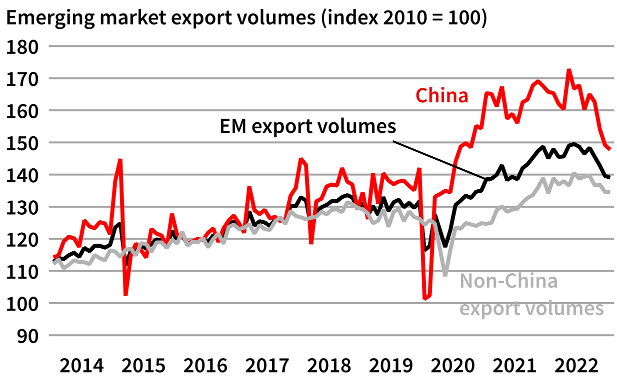
Services drive the strengthening in EM PMIs



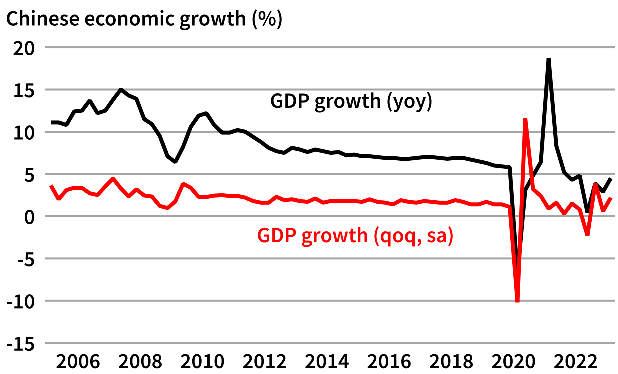
China's infrastructure sector outpacing services



EM export volumes suffering from weaker goods demand



China's economic growth accelerated in Q1



Sources: Macrobond, NAB Group Economics

Global forecasts and risks: global growth set to slow; outlook faces broad range of risks

Global business surveys have continued to show an improving trend in early 2023. The JP Morgan global composite PMI strengthened in March – up to 53.4 points (compared with 52.1 points previously). However, this improvement was far from broad based – driven by the services sector, where readings are somewhat stronger for emerging markets than for advanced economies, while the global manufacturing PMI was marginally negative.

Our global economic forecasts are little changed this month. Despite the comparative strength in business surveys at the start of the year, we continue to anticipate a sharp slowdown in activity in 2023 – with growth at 2.7% (up from 2.6% reflecting an upwards revision to China). Excluding the downturns associated with the global financial crisis and COVID-19 impacted 2020, this would be the slowest rate of growth since 2001.

We continue to anticipate similarly weak growth in 2024 before a modest recovery to 3.2% in 2025 – below the long run average of 3.4% recorded between 1980 and 2022.

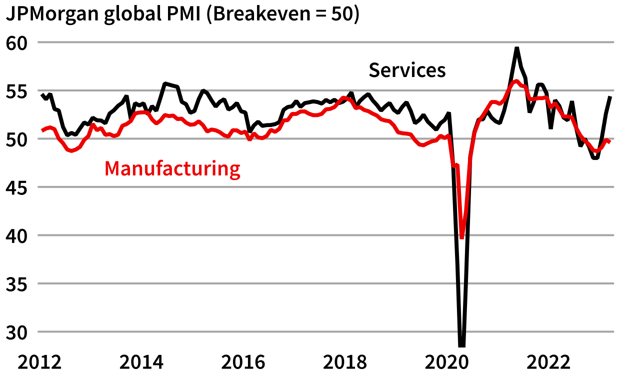
There remain a broad range of risks to our global outlook. While fears of financial contagion following recent bank collapses in the United States and Europe appear to have eased, the rapid increase in central bank policy rates in most advanced economies has led to a repricing of risk and assets and further financial sector strain cannot be ruled out. The degree to which tighter lending standards slow activity in the near term is uncertain.

Similarly, the path of policy rates going forward remains unclear. The banking sector fears drove market expectations for both the US Federal Reserve and European Central Bank rates considerably lower in mid-March, and although they have subsequently risen from these lows, they remain (in mid-April) below those seen at the start of March.

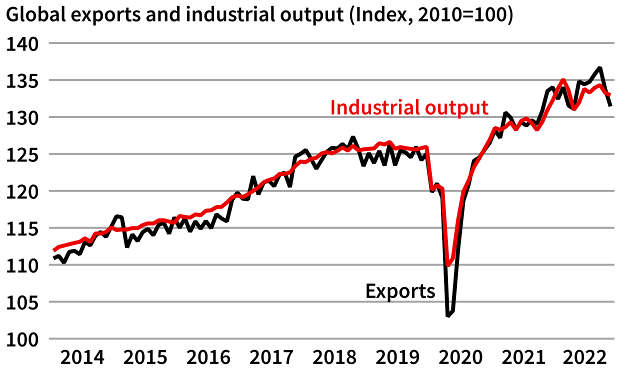
Should major central banks follow a more dovish approach to monetary policy moving forward, this adds additional uncertainty to the inflation outlook. While consumer price growth has eased, it remains relatively sticky – persisting at rates well above central bank targets. In its latest World Economic Outlook, the International Monetary Fund has signalled that inflation may remain above target in many major economies until 2025 – which could present challenges around wage setting and employment conditions.

Geopolitical factors also present risk across the outlook period. The Russia-Ukraine conflict has persisted, with no resolution in sight, with uncertainty around the supply of energy and agricultural commodities. Tensions between the United States and China also remain and appear unlikely to improve in the near term – particularly following China's military exercises around Taiwan in April.

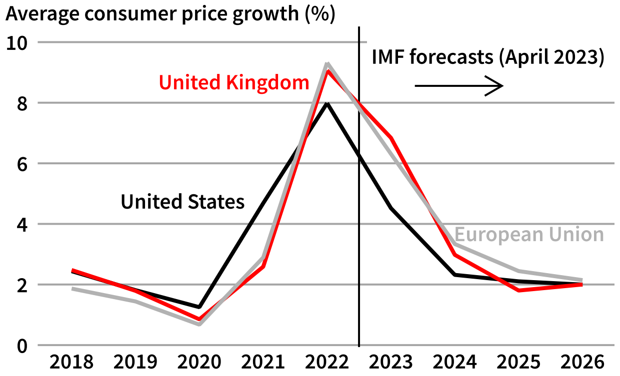
EMs led service rebound, but growth set to slow



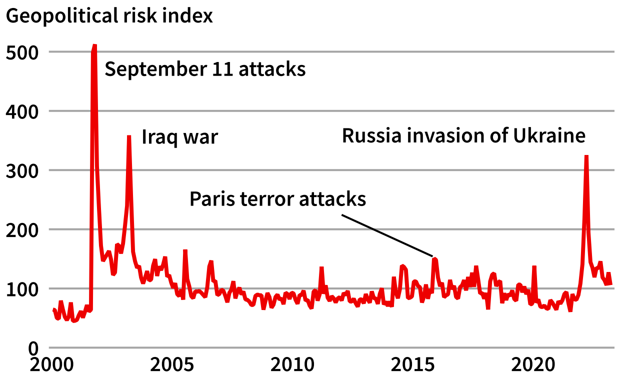
Global growth outlook remains below long run average



IMF expect inflation to remain high in near-term



Geopolitical risk elevated by historical standards



Sources: Macrobond, Caldara, Dario, and Matteo Iacoviello (2021), "Measuring Geopolitical Risk," working paper, Board of Governors of the Federal Reserve Board, November 2021", NAB Group Economics

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