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The Forward View: Global May 2023

Global growth set to slow from robust Q1 results

NAB Group Economics

Overview

- Banking stress remains an issue in the US with the failure of First Republic Bank in early May. Financial market reaction has been more muted than in March. That said, surveys of loan officers point to an on-going tightening in credit supply conditions in the US and Europe. The same surveys also point to a significant weakening in loan demand.
- Global inflation has slowed in recent months. We estimate global CPI inflation of 7.0% yoy in March 2023, down from a peak of 9.6% yoy last year. This is still too high, and measures of core inflation in advanced economies are proving to be sticky.
- The US, Euro-zone and UK economies all grew in Q1, but at a subdued pace, and we expect Canada and Japan to also record positive growth. However, due to the lagged effects of monetary policy tightening and the tightening in lending standards from the banking issues, we remain bearish on the outlook.
- Business surveys continue to point to relatively robust conditions in emerging markets, particularly in the services sector. Weak global demand for goods (reflecting generally slower growth and the switch to services) is impacting EM and east Asian growth as it is relatively trade dependent, with Taiwan falling into recession.
- We estimate Q1 world GDP growth was 0.9% q/q, up from 0.1% in Q4 2022, with around 40% of this growth coming from China. Growth should slow in Q2, as the boost to China's growth from the removal of COVID restrictions fades, and also because of weaker advanced economy growth. Challenging this view, the global PMI continued to improve in April signalling some possible near-term upside risk. However, downside risk is coming from still high and sticky core inflation; while we expect the major central bank policy rates are at or near their peak, if inflation does not decline as expected this may push them to move higher.
- For each of 2023 and 2024 we still expect growth of 2.7%. Excluding the global financial crisis and COVID-19 impacted 2020, this would be the slowest rate of growth since 2001.

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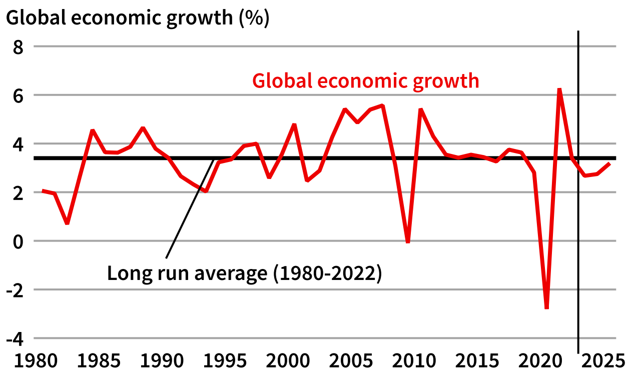
Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.0	0.9	1.9
Euro-zone	-6.3	5.3	3.5	0.8	0.7	1.2
Japan	-4.3	2.2	1.5	0.8	0.6	0.8
UK	-11.0	7.6	4.1	0.4	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	1.1	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	0.8	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**

Slow going ahead for the global economy



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

Financial and commodity markets: fresh jitters in US banking; inflation slowing but not yet tamed

Fears around the stability of the US banking sector returned in early May, with the failure of First Republic Bank. Although the number of failures so far this year is not usual by recent historical standards, the total value of assets of the failed banks far exceeds the norm.

The collapse of First Republic led to a sell-off of banking stocks – reflecting broader concerns around the ongoing viability of smaller regional banks, in part due to deposit flight to larger competitors, meaning that this may not be the last bank to go under. Weakness in the banking sector meant that equity markets in both the US and other advanced economies (as measured by the MSCI indices) have broadly tracked sideways from late March through mid-May.

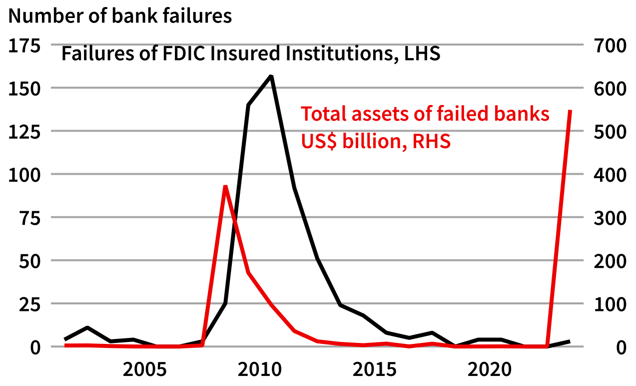
Despite the recent failure, bond market volatility has not spiked in a similar fashion to the earlier crisis in March – likely reflecting that current instability in the US banking sector is already priced in and the swift action of regulators to contain contagion risk. That said, current bond market volatility remains comparatively high – above the trend exhibited between the global financial crisis and the initial outbreak of COVID-19.

Fears around the banking sector in the United States and elsewhere remain in the context of the rapid tightening in monetary policy since early 2022. The US Federal Reserve, European Central Bank and Bank of England increased rates in May by 25 basis points, reflecting inflation that has persisted well above target rates for longer than anticipated. We believe that central banks may be close to their peak, with financial institutions tightening lending standards and increasing caution around counterparty risk – providing additional tightening to overall financial conditions without further policy rate hikes.

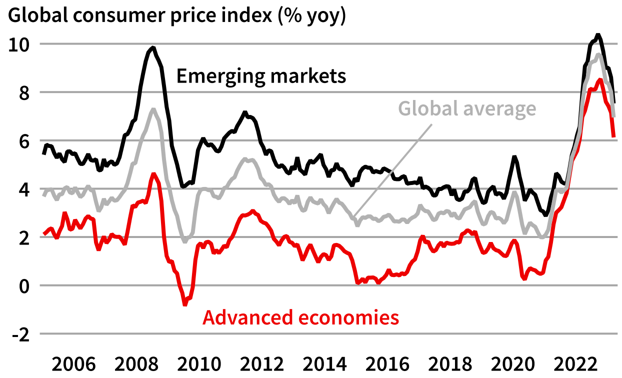
Global inflation has slowed in recent months – with our estimate at 7.0% yoy in March 2023 – down from a peak of around 9.6% yoy in September 2022, but still well above the rates that inflation targeting central banks are aiming for. Supply side pressures are continuing to ease, with the Federal Reserve Bank of New York's Global Supply Chain Pressure Index dropping below its long-term average in February and below pre-pandemic/US-China trade war trends in April.

Global commodity prices – as measured by the aggregate S&P GSCI index – have drifted lower since mid-April, with lower energy prices the main contributor to this trend. West Texas Intermediate crude oil briefly rallied above US$80 a barrel around this mid-April peak – following the announcement of production cuts by OPEC+ members, however prices have subsequently fallen, with weakening economic activity likely to keep global demand relatively subdued.

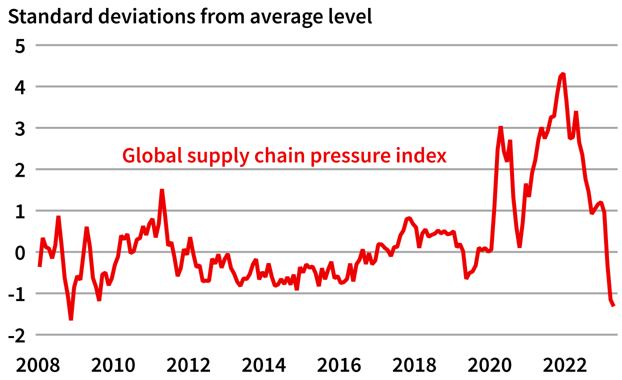
US bank failures historically high in value terms



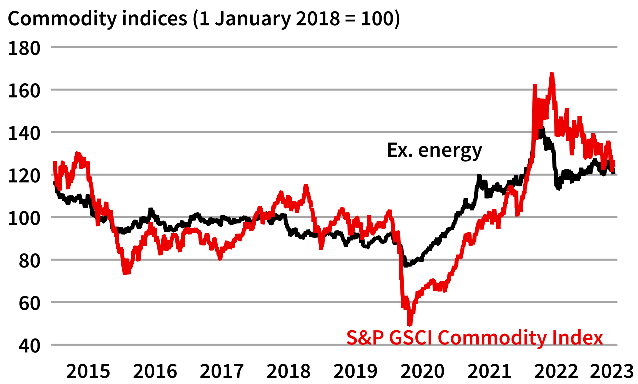
Inflation tracking lower but still comparatively strong



Supply side pressures continue to erode



Energy prices have fallen despite oil production cuts



Sources: FDIC, Macrobond, NAB Group Economics

Advanced economies: Major advanced economy growth subdued early in 2023

The US, Euro-zone and UK economies all grew in Q1, but at a subdued pace. Monthly GDP data point to solid growth in the quarter for Canada, while we expect the Japan GDP data (released today) to show growth strengthened.

US Q1 GDP growth of 1.1% q/q (annualised) was below our expectations (of 1.7%) although the details were better as the slowdown was largely driven by inventories, with domestic final demand growth strengthening.

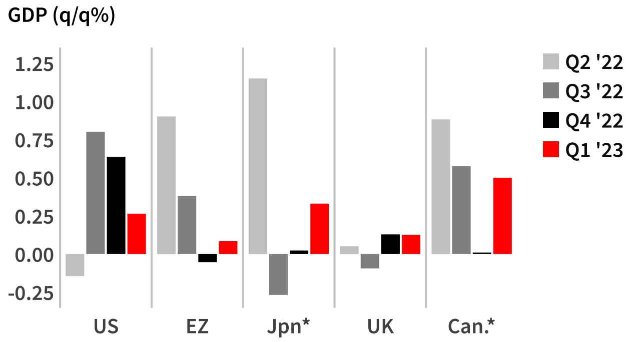
The Euro-zone grew by 0.1% q/q in Q1, but this followed a small fall in Q4, pointing to an economy broadly at a standstill for half a year. The UK also managed to eke out 0.1% growth in the quarter (as in Q4 2022 but over the last year growth was a very weak 0.2%. So while both economies have avoided two consecutive quarters of negative GDP growth (a so called technical recession) the impact of last year's commodity price shock is evident. However, with the fall in energy prices in H2 2022, business surveys indicate a turnaround from late last year driven by services and European labour markets remain very tight and inflation elevated.

In Japan, the economy struggled in H2 2022 but we expect growth in Q1 of 0.3% q/q, given the strength in monthly data on consumption, machinery orders and net exports. The slowdown in the global economy, and switch in demand to services, continues to be a headwind for manufacturers. Nevertheless, the economy should continue to grow helped by COVID re-opening (particularly in tourism, with restrictions on overseas tourists further relaxed in April), and the easing in global energy prices.

Strains in the US banking system are still evident with more banks coming under pressure in recent weeks. Central bank surveys of bank loan officers provide a window into one channel through which these strains can affect the economy. While the pace of tightening in US and Euro-zone banks standards for business loans was broadly unchanged in Q2, the surveys indicate there has been a material, sustained tightening in credit supply. The surveys also report on loan demand; in the Euro-zone there was a large shift down in Q2 and US business loan demand continued to weaken. In both cases, loan demand is at levels normally accompanied by a contraction in activity. Loan demand has also softened in the UK.

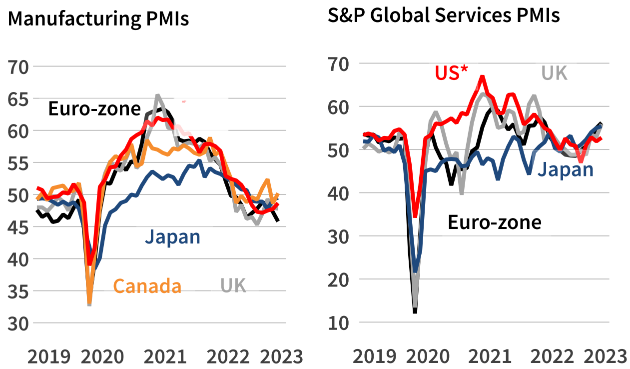
Reflecting this, and the lagged effects of monetary policy tightening, we remain bearish on the outlook. We expect the US economy to contract at some point this year (with falls in Q2 and Q3 pencilled in). This will spill over to Canada, which is also battling falling energy prices given it is a commodity exporter. For the Euro-zone and UK, the cross winds from policy tightening but energy price relief should see subdued growth, with moderate growth expected for Japan.

Euro-zone & UK eke out growth in Q1; US slows

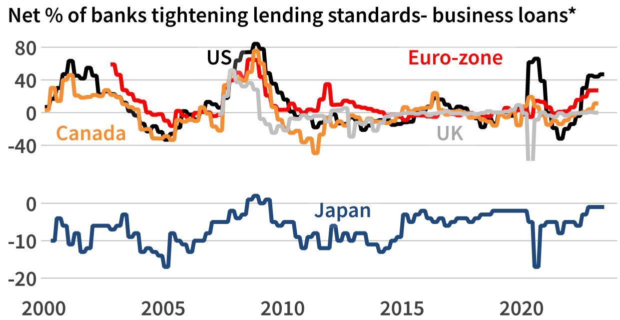


Source: Macrobond. * Japan and Canada Q1'23 are NAB forecasts

Service/manufacturing divide continues

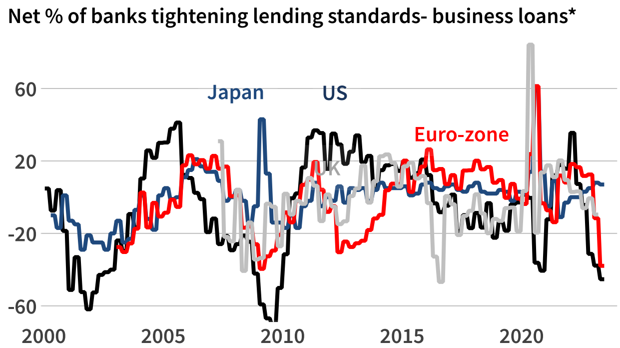


Loan standards tightening – particularly US/Euro-zone



* US domestic banks, C&I loans to large firms; UK availability of credit indicator; Japan large firms

Firm loan demand weak outside Japan



* UK - large PNFCs

Emerging markets: surveys point to services strength, but weaker exports set to weigh on growth

Business surveys continue to point to relatively robust conditions in emerging markets. Overall, the EM composite PMI edged higher to 54.9 points in April (from 54.6 points previously) albeit there is a wide disparity in the underlying survey measures by sector and country.

The EM services PMI has continued to trend higher – up to 57.3 points in April (from 56.7 points previously), having been in negative territory as recently as November 2022. This outcome was driven by an upturn in India's services PMI – which rose to its strongest reading since June 2010 – while China's reading was marginally softer (despite remaining strong), with this sector continuing to recover following the abandonment of zero-COVID policies.

China's Labour Day holidays (which overlapped the start of May) saw a strong rebound in domestic tourism, unlike the relatively subdued conditions over Chinese New Year. According to data from the Ministry of Culture and Tourism, tourism revenue for this holiday more than doubled in 2023 (having been impacted by COVID-19 last year) and rose above 2019 levels for the first time.

In contrast to the strength in services, the EM manufacturing survey has continued to drift lower, down to 50.5 points in April (from 50.7 points in March). China's manufacturing PMI has dropped into negative territory, while India's measure strengthened (and remained strongly positive) – citing the strength of demand as the key driver.

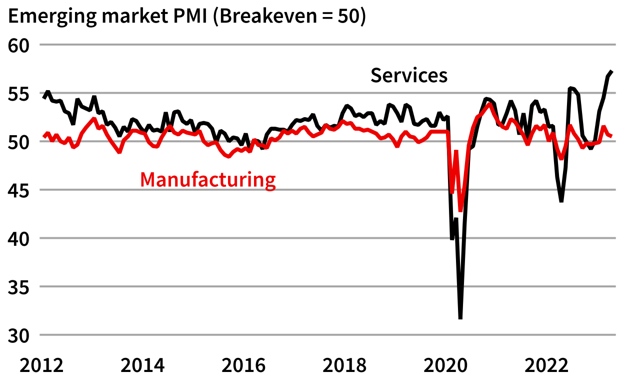
Overall global demand for goods is set to ease in 2023, reflecting the impact of tighter monetary policy and the rebalancing in consumption back towards services. Emerging market growth is generally more trade dependent than that of advanced economies, meaning that this will present a headwind to growth in the near-term.

Global trade data show that emerging market trade volumes contracted by 4.6% yoy in February 2023. China's export volumes have contracted a little more rapidly – down 5.5% yoy – in part reflecting that China was a major beneficiary of the growth in goods demand during the peak of the COVID-19 pandemic.

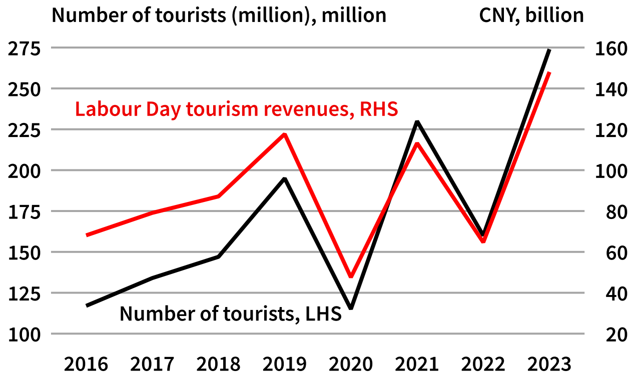
East Asia (excluding China) will also be negatively impacted by weaker trade flows. Growth in the region slowed in Q1 2023 – down to 2.7% yoy (from 2.9% yoy in Q4 2022) – having recorded much more robust growth earlier in 2022, broadly in line with pre-pandemic trends.

A key contributor to recent weakness in East Asian growth has been Taiwan – which fell into recession after recording its weakest growth since the Global Financial Crisis in Q1. Weaker global demand for electronics saw total exports fall sharply, with little prospect for a rapid recovery in the near term.

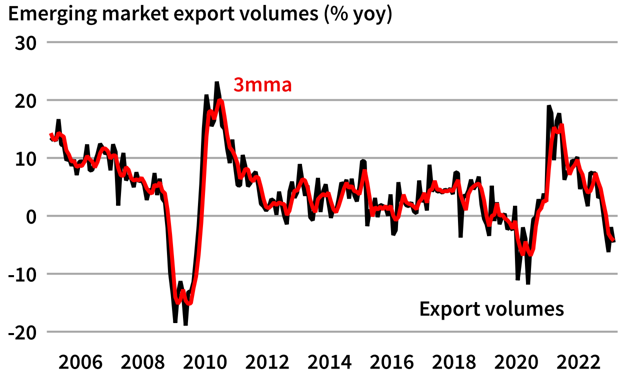
Disparity between manufacturing and services widens



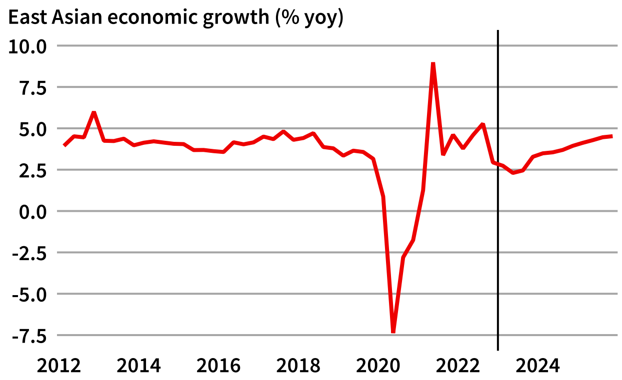
Labour Day holiday shows domestic tourism recovery



Emerging market export volumes falling year-on-year



Near term growth prospects weak for East Asia



Global forecasts and risks: Business surveys offer (near-term) hope, but outlook still gloomy

Global business surveys made further gains in April, driven by the services sector. The JPMorgan global composite PMI strengthened in April to 54.2 points (from 53.4 in March), its highest level since end 2021. The improvement remains centred on services, with manufacturing still moribund. The latter reflects the slowing in growth and tighter financial conditions, an inventory correction and a switch towards services consumption. While China had been a driver of the improvement, its services PMI was softer in April, but this was offset by an upturn in advanced economy and other emerging market economies survey readings.

While not all countries have reported their Q1 GDP results yet, it is evident that there was a bounce in GDP growth in the quarter. We estimate Q1 world GDP growth was 0.9% q/q, up from 0.1% in Q4 2022, with around 40% of this growth coming from China. Our forecasts see a slowdown in growth from Q2, as the boost to China's growth from the removal of COVID restrictions fades, and also from weaker advanced economy growth (particularly in the US).

For 2023 as a whole, we still expect growth of 2.7%, and a similar outcome in 2024. Excluding the global financial crisis and COVID-19 impacted 2020, this would be the slowest rate of growth since 2001. This should see some easing in central banks settings and so we are factoring in a modest upturn in global growth in 2025 (to 3.2%).

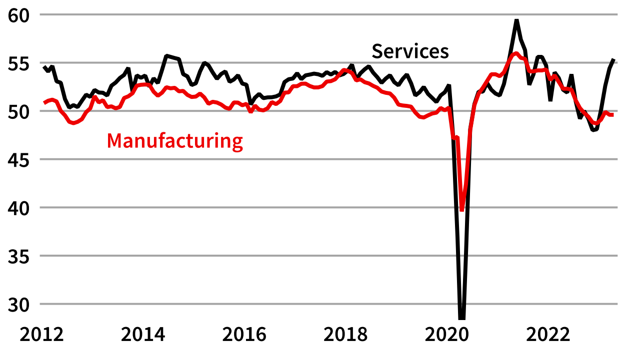
There remain a range of risks to our global outlook. The general resilience of many economies in the face of multiple shocks (policy tightening, energy prices), perhaps supported by savings accumulated during the pandemic, and the strength of the PMIs in early Q2, suggests there is some near-term upside risk to our growth forecasts. However, the full impact of the significant global monetary policy tightening that has occurred is yet to be fully felt and it should ultimately weigh on growth.

Our forecasts are based on a view that rates have either peaked (e.g. US) or are near their peak (Euro-zone). However, the risk is that there will be additional tightening as, while headline inflation has fallen, measures of underlying inflation are proving to be sticky. Moreover, any near-term upside risk also implies a longer term downside risk as it suggests labour markets will stay tight, keeping the pressure on wages and reduces one source of downward pressure on prices. Sticky core inflation – in the face of the growth slowdown that has occurred and the improvement in supply chains – also raises the possibility that to get inflation down, the slowdown in growth will need to be even greater than we have projected.

Other downside risks come from continuing bank stresses and the as yet unresolved debt ceiling in the US, the possibility that further financial system strains will emerge, and geopolitics. The Russia-Ukraine conflict persists, with no resolution in sight, and tensions between the United States and China also remain.

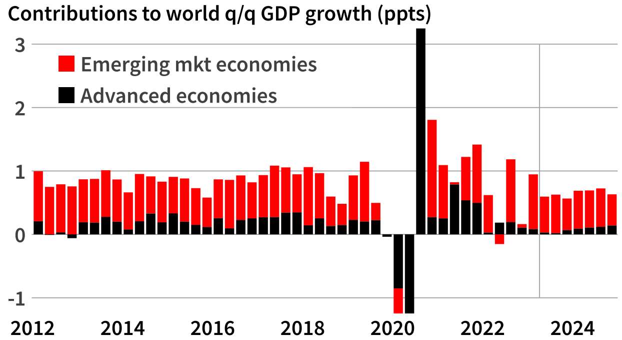
Service sector rebound continued into April

JPMorgan global PMI (Breakeven = 50)



Q1 GDP bounce not expected to be sustained

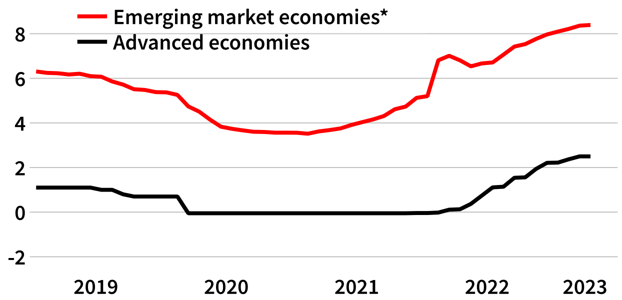
Contributions to world q/q GDP growth (ppts)



NAB forecasts from Q1 2023. Y--axis scale cut-off in 2020.

Policy tightening not limited to major AE central banks

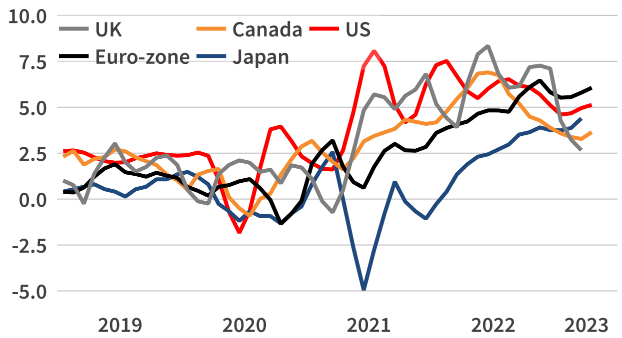
Central bank policy rates (GDP weighted averages, %)



* 19 country index; note excludes China, Turkey, Argentina

Expect near peak on rates – but inflation needs to fall for this to be realised and core measures proving sticky

Core CPI (3mth/3mth % change, annualised)



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