Embargoed until 11:30am AEST 21 June 2023

The Forward View: Global June 2023

Global growth set to slow as monetary policy bites

NAB Group Economics

Overview

- Fears around the US banking sector have eased since mid-May, with central banks' focus returning to inflation (around 6.3% yoy in April) that remains well above target ranges. The ECB hiked in June, and while the US Fed paused, both banks are likely to increase rates in July.

- While market expectations suggest both central banks are near the peak (fully pricing in one additional increase for both), persistent inflation could drive policy rates higher, adding downside risk to our forecasts.

- Economic growth across the major advanced economies has been mixed, highlighted by the contraction in the Euro-zone over Q4 2022 and Q1 2023, while Japan saw growth recover over this period. While the fall in energy prices will help some economies (notably in Europe and Japan) the tightening in monetary policy is likely to keep growth generally subdued.

- Stronger readings for emerging market surveys in May were largely driven by China. The strength of China's services PMI is somewhat at odds with ongoing signs of weakness in the country's domestic demand. Softer goods demand in advanced economies will impact trade activity going forward – hitting EM growth.

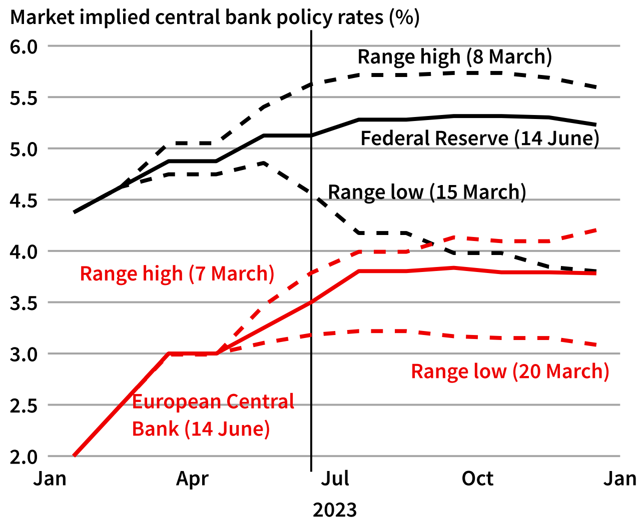
- Overall, our forecast for global economic growth in 2023 is slightly higher this month – reflecting the impact of stronger than anticipated activity in India, a pushing back of the expected slowdown in US growth to H2 2023 (which negatively impacts the global outlook in 2024) and a pickup in Latin America. We expect the global economy to expand by 2.8% in 2023 (from 2.7% previously), before slowing to 2.6% in 2024 (2.7% previously). Excluding the outliers of the Global Financial Crisis and initial wave of COVID-19, this would be the slowest rate of growth since 2001. We expect a modest upturn in 2025 (to 3.1%).

Table of Contents

Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.3	0.6	1.8
Euro-zone	-6.2	5.3	3.5	0.6	0.8	1.1
Japan	-4.3	2.2	1.5	1.2	0.6	0.8
UK	-11.0	7.6	4.1	0.4	0.6	0.9
Canada	-5.1	5.0	3.4	1.5	0.6	1.4
China	2.2	8.1	3.0	5.6	4.5	4.8
India	-6.0	8.9	6.7	5.6	5.6	6.2
Latin America	-6.8	7.0	4.0	1.6	1.0	1.8
Other East Asia	-2.8	4.5	4.2	2.8	3.6	4.2
Australia	-1.8	5.2	3.7	1.3	0.5	1.9
NZ	-1.5	6.0	2.4	0.6	0.2	2.3
Global	**-2.8**	**6.3**	**3.4**	**2.8**	**2.6**	**3.1**

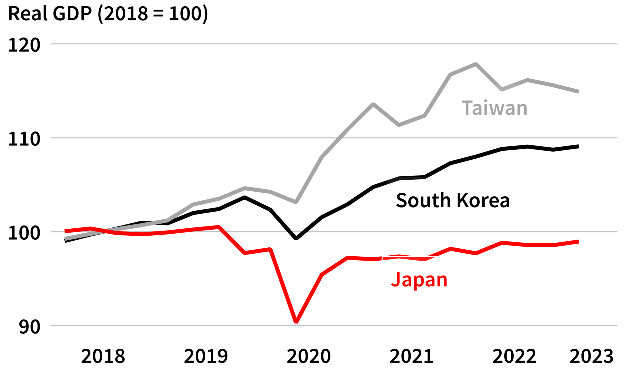
Markets price one further rate hike from the US Fed and ECB, but inflation trends present upside risk



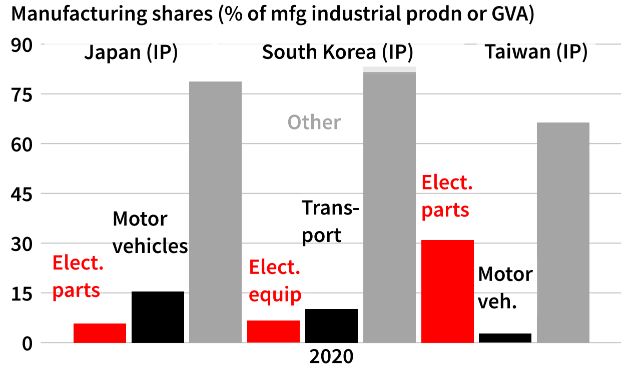
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: Taiwan's economy – which performed strongly in the aftermath of the pandemic – has contracted over the last year as global demand for high tech exports such as semi-conductors has fallen. This has also been a drag for Japan and South Korea, but they are less exposed to the tech cycle and the ongoing recovery in auto production has partially offset the broader manufacturing downturn

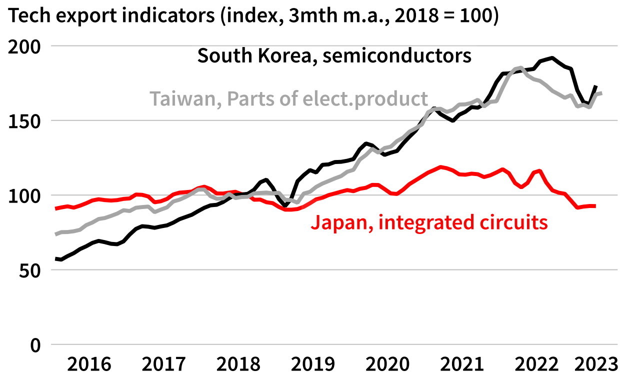
Taiwan came out of the pandemic strongly, with South Korea also holding up, helped by world goods demand including for tech – but it has struggled over the last year



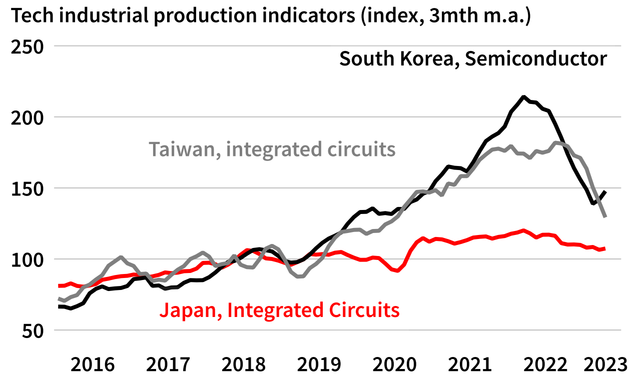
Taiwan industry has a large concentration in high tech; South Korea more balanced while Japan has large motor vehicle industry



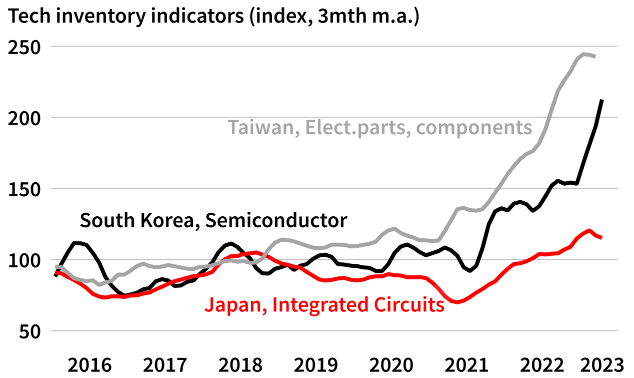
Tech exports came under pressure as demand switched back to services and as customer inventories were rebuilt… but there are tentative signs of stabilisation



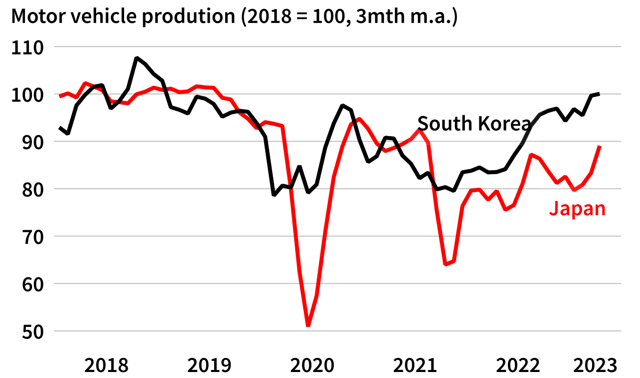
With demand falling, tech production was also wound back



Despite production cutbacks, inventories have risen to high levels, although, again, tentative signs they may have peaked (in Taiwan and Japan)



Auto sector recovery was more drawn out, particularly in Japan. While manufacturing is generally suffering from downturn in goods demand, auto prodn still trending up



Sources: Macrobond, Refinitiv, NAB Group Economics

Financial and commodity markets: banking fears subside, central banks still targeting inflation

Fears around the US banking sector appear to have eased once again – following the failure of First Republic Bank in early May. Excluding the COVID-19 related plunge in early 2020, the US banking equities index fell in early May to its lowest levels since August 2016, before subsequently recovering to mid-March levels (post the initial fears).

More generally, US equity markets (as measured by the MSCI index) have trended higher since late May (up to their highest levels since August 2022, but still well below their peaks of early 2022). It is worth noting that these gains were concentrated among the eight largest tech firms (with the rest of the S&P 500 trending lower since late May). In contrast to the stronger trend in the US, other advanced economies and emerging markets have essentially tracked sideways since the start of the year.

Despite the fears around stability in the banking sector, volatility in equity markets (as measured by the VIX index) has generally eased in recent months – trending down from a recent cycle peak in October 2022 (despite a modest upturn in early March). In contrast, volatility in bond markets has been remained relatively high – the MOVE index is above trends observed post the Global Financial Crisis until 2022.

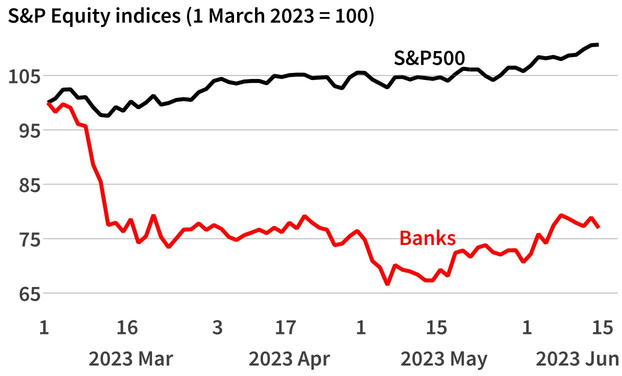
Government bond yields for most major advanced economies remain below their early March peaks – in part reflecting a downward shift in market expectations around central bank policy rates (with stricter lending standards among financial institutions following the bank fears seen as effectively providing additional monetary tightening). The key exception is the UK, where the 10-year bond yield rose rapidly above 4% following a higher-than-anticipated inflation print (particularly an uptick in core inflation).

Overall, global inflation has continued to trend lower – down to around 6.3% yoy in April 2023. While this has slowed from a peak of around 9.6% yoy in September 2022, inflation has proved to be sticky – persisting at high rates for longer than major central banks had anticipated. Among the advanced economies, the US is leading the way lower, with the CPI up 4.1% in May (despite core inflation remaining relatively strong).

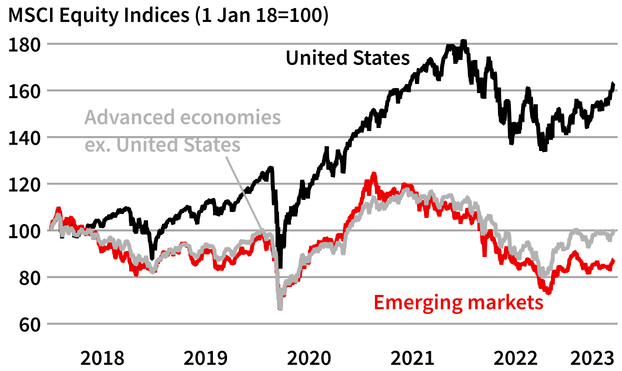
With inflation still above target in most economies, major central banks remain on a tightening bias. The European Central Bank (ECB) raised rates by 25 basis points in June, while the US Federal Reserve (Fed) paused, albeit noting that a hike in July remains in play. Market expectations continue to suggest that both the Fed and ECB are near the peak of the current hiking cycle (with one further hike priced in for both institutions).

Commodity prices – as measured by the S&P GSCI – have largely tracked sideways since early May, with lower energy prices offset by an upturn in non-energy commodities (on speculation of Chinese stimulus).

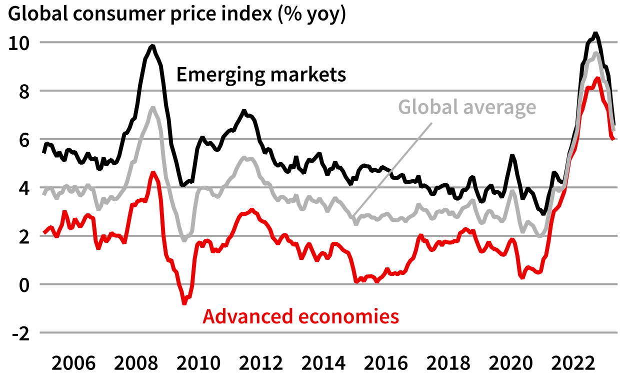
US bank equities back to mid-March levels



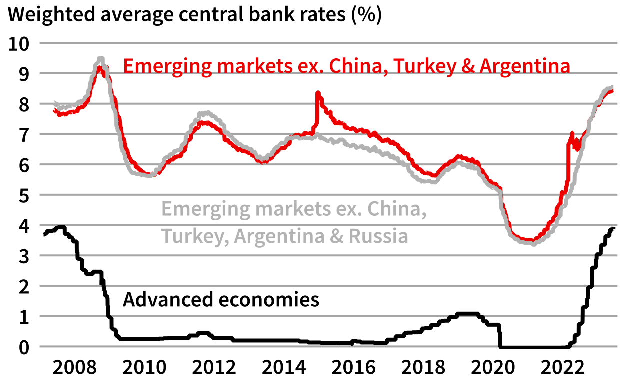
Tech stocks drove US equities to highest since Aug-22



Global inflation tracking gradually lower



Major central banks near policy rate peak



Advanced economies: As policy continues to tighten, the growth outlook remains weak

Euro-zone GDP growth in Q1 was revised down from +0.1% to -0.1% q/q. With GDP also having fallen in Q4 2022 (also -0.1%), the 'technical recession' marker of two consecutive quarterly declines has been met. These data are still subject to revision, so conceivably it could move out of recession again. Regardless, it is clear that the Euro-zone economy came to a standstill at end 2022/early 2023 principally due to the impact of last year's energy price shock. This shock also weighed on the UK economy which only grew by 0.2% over the year to Q1 2023.

In contrast, Q1 GDP growth in Japan was revised up to 0.7% q/q from 0.4%. Japan struggled in H2 2022, but is now enjoying a bounce in growth, helped along by the removal of remaining COVID restrictions (including on overseas tourists this quarter). Japan's auto sector has also continued its drawn out recovery (see p2) and, while weak global growth may constrain exports, the continued rise in the PMIs suggests momentum remains positive.

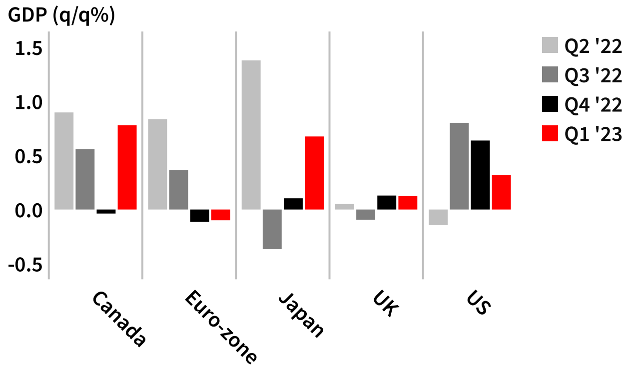
We expect the Euro-zone economy will grow in Q2, helped by the fall in energy prices. However, the continued tightening of monetary policy is a growing headwind. The ECB raised rates again this month and signalled another hike in July. The net result will likely be subdued growth.

The Euro-zone PMIs are consistent with moderate growth in Q2, even with the manufacturing sector PMI continuing to slide. However, while still solid, the services PMI in the Euro-zone recorded its first fall since late 2022, and the UK services indicator fell (but both are still at a solid level).

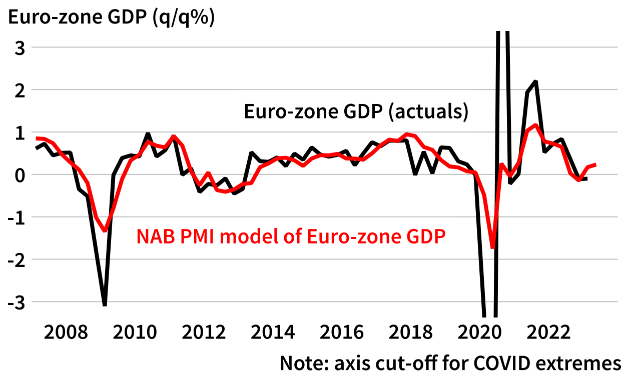
The average of the US S&P Global and ISM services PMIs also inched down but the two indicators moved in opposite direction, making interpretation difficult. The ISM measure is now at levels seen during recessions (or their aftermath) but the S&P Global measure has been recovering. Partial data early in the quarter point to continued growth and so we recently moved out our expectation of when the US economy might contract to H2 2023. We also now expect that the Fed will raise rates again in July and pushed out the date at which we expect the Fed to start cutting rates (to Q1 2024). This means interest rates will be higher over the forecast horizon, leading us to shave our 2024/25 forecasts.

While growth may have generally slowed, labour markets remain tight, maintaining pressure on wages. Similarly, while headline inflation is coming down, core measures remain elevated (although there are some positive signs in recent US and Euro-zone data). Because of this, there continues to be upwards pressure on major central bank policy rates. A clear, sustained shift down in inflation will be needed to break this cycle. Accordingly, the main risk to the outlook remains that persistent high inflation forces central banks to raise rates to the point that there are significant corrections in advanced economies.

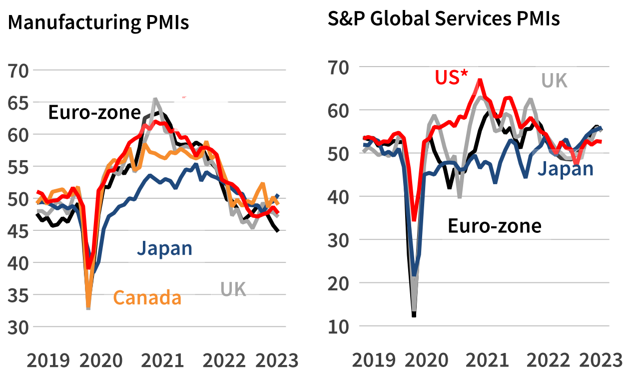
Revisions: Euro-zone 'recession', Japan stronger



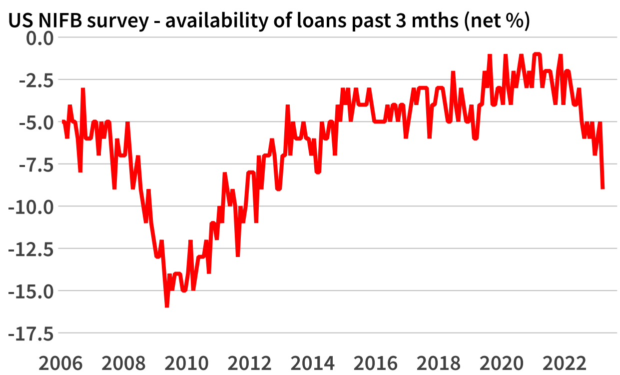
Eurozone likely to resume grow in Q2



Services still leading the way but may have peaked



Labour markets still very tight



Emerging markets: service sector outperforming; manufacturing hit by weaker global demand

Business surveys in emerging markets remained comparatively strong in May. Overall, the EM composite PMI pushed higher to 55.6 points (from 54.9 points previously), despite an easing in the services measure that had been the key driver in recent months.

The EM manufacturing PMI moved up to 51.4 points (from 50.5 points in April). The key driver of this upturn was China – where the Caixin manufacturing PMI switched from a negative reading in April to a positive one in May – supported by an upturn in India's measure as well.

It is worth noting that China's official manufacturing PMI dropped further into negative territory in May. Substituting this outcome for the Caixin measure would result in the overall EM composite PMI pushing lower this month – highlighting the importance of China to the overall measure.

The EM services PMI drifted slightly lower – albeit remaining at strongly expansionary levels – to 56.7 points in May (from 57.3 points previously). Trends diverged between major economies – with a stronger reading in China offset by weaker results for both India (albeit remaining very positive) and Russia.

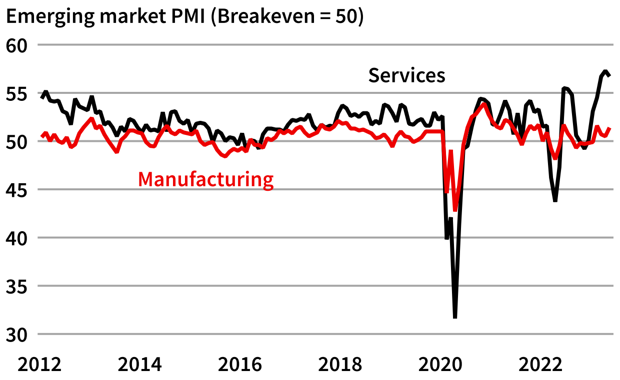
The strength of China's services PMI is somewhat at odds with ongoing signs of weakness in the country's domestic demand. While not encompassing the complete range of services, China's retail sales growth has been relatively weak (when accounting for the impact of base effects). Similarly, consumer prices have barely increased in recent months, and policy makers are mulling further stimulus – including further monetary easing and support for the beleaguered property sector. Given weakness in consumer confidence, it is not clear that such measures would have a material impact on China's growth in the near-term.

India's first quarter economic growth was stronger than anticipated – increasing by 6.1% yoy (compared with consensus forecasts around 5.0% yoy). While domestic consumption was relatively subdued, strong growth in capital investment and exports were key drivers of this increase.

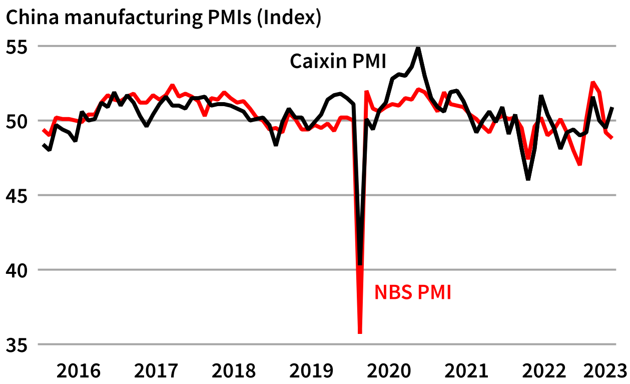
Growth in emerging markets is typically more trade dependent than for advanced economies. The impact of tightening financial conditions and the rebalancing of consumption towards services is set to negatively impact emerging markets in the near-term.

Global trade data are available to March and show a surprise spike in EM export volumes in the final month. This increase was driven by a 16.2% yoy increase in exports from China – albeit this appears somewhat anomalous. When a three-month moving average is applied, the increase falls to just 1.3% yoy (highlighting the weakness in both January and February), while subsequent Chinese trade data has softened considerably.

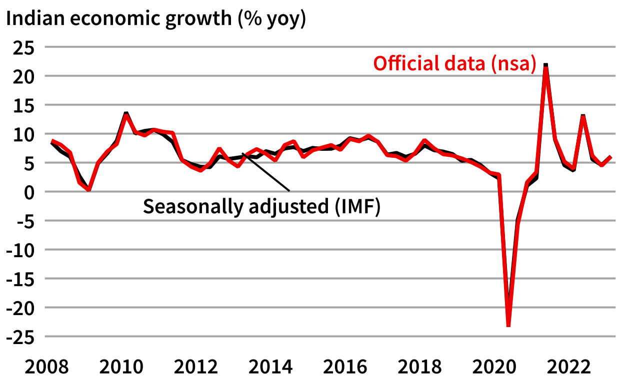
Stronger manufacturing drove composite PMI higher…



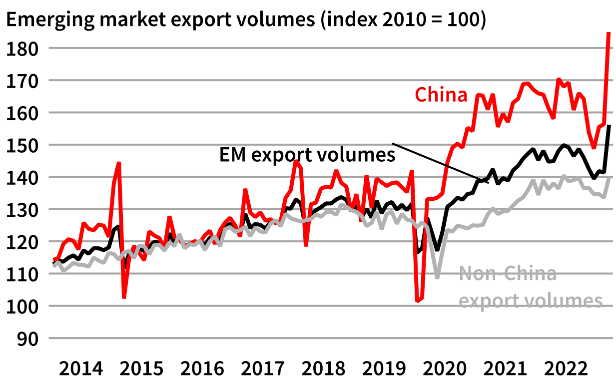
…but divergent trends in Chinese manufacturing PMIs



India's growth was stronger than expected in Q1



Spike in China's export volumes anomalous



Sources: Macrobond, NAB Group Economics

Global forecasts and risks: stronger near-term growth negatively impacts outlook for 2024

Global business surveys edged marginally higher in May, with the JPMorgan global composite PMI at 54.4 points (up from 54.2 points in April). The upturn in this measure since December 2022 has been driven by the services sector – with readings in both advanced economies and emerging markets strengthening since late last year (albeit EM services eased marginally from high levels in May).

In contrast, the global manufacturing PMI has remained in negative territory since September 2022. Modest gains in the EM measure have been offset by declines in the advanced economies.

This trend is broadly consistent with data on global industrial production – where historically modest year-on-year growth in global output reflects aggregate gains in EMs that were partially offset by lower production in advanced economies.

Overall, our forecast for global economic growth in 2023 is slightly higher this month – reflecting the impact of stronger than anticipated activity in India, a pushing back of the expected slowdown in US growth to H2 2023 (which negatively impacts the global outlook in 2024) and a pickup in Latin America. We expect the global economy to expand by 2.8% in 2023 (from 2.7% previously), before slowing to 2.6% in 2024 (2.7% previously). Excluding the outliers of the Global Financial Crisis and initial wave of COVID-19, this would be the slowest rate of growth since 2001. We expect a modest upturn in 2025 (to 3.1%).

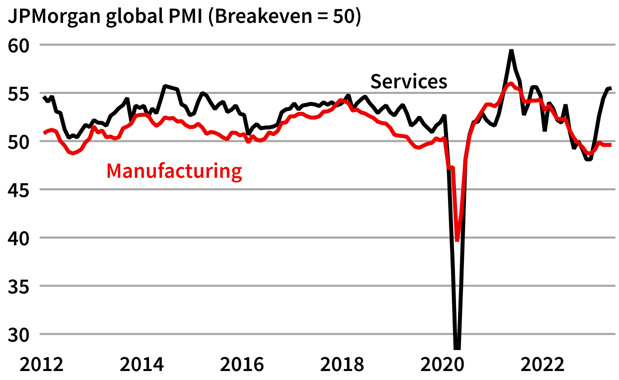
There remain a range of risks to this outlook. This includes uncertainty around monetary policy (given the persistence of inflation above central bank targets) – with the risk that various major central banks could hike policy rates above our current expectations, leading to deeper than anticipated slowing in activity (including the risk of recession in many regions). Similarly, there is uncertainty as to when the easing of monetary policy will commence.

In contrast, China's economic recovery from its zero-COVID policies appears close to stalling – with the anticipated rebound in consumption yet to eventuate. While policy makers have been considering stimulus, proposals have largely been supply side measures, with little indication that these will revive flagging demand.

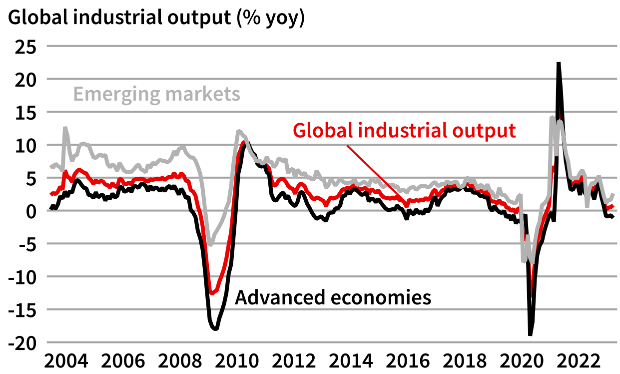
While fears around financial stability in the US have cooled again since early May, there remains risk of further strains in the financial markets emerging. Further policy rate rises could reveal previously unidentified vulnerabilities.

Similarly, there remain geopolitical risks to the outlook. The Russia-Ukraine conflict has persisted for over a year, with little prospect of a near-term resolution, while tensions between China and the United States remain – albeit with an opportunity for improvement with US Secretary of State Blinken currently visiting China.

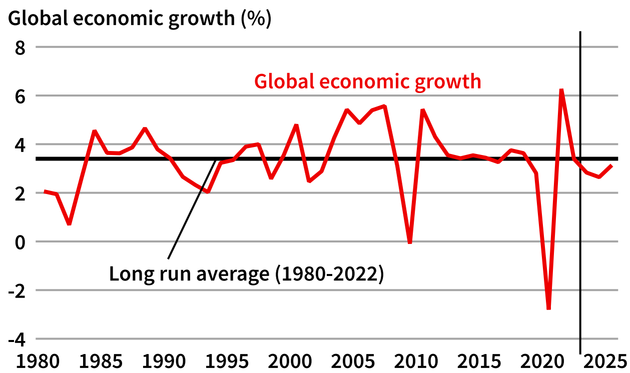
Stark differences between services and manufacturing



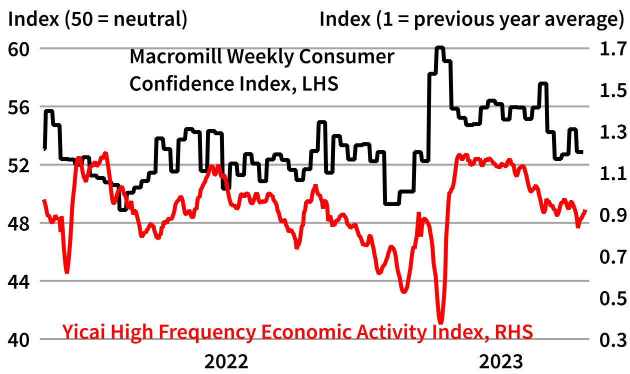
Modest growth in global industrial production



Global growth to slow further into 2024



High frequency data in China show stalling from April



Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 422 081 046

Brody Viney
Senior Economist
+(61 0) 452 673 400

Phin Ziebell
Senior Economist
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Chief Economist
Corporate & Institutional Banking
+(61 2) 9293 7168

Skye Masters
Head of Markets Strategy
Markets, Corporate & Institutional Banking
+(61 2) 9295 1196

Important notice