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The Forward View: Global July 2023

China's weak Q2 growth presages weaker global growth

NAB Group Economics

Overview

- China's economy grew by 0.8% on a quarter-on-quarter basis in Q2, down from 2.2% in Q1, as its post-zero-COVID rebound faded, with consumer demand still tepid, ongoing weakness in the residential property sector and easing goods demand in major trading partners.

- The China GDP data is the first released for the quarter, but global growth appears to have slowed more broadly in Q2, including India and Latin America, although major advanced economy growth was likely similar to that seen in Q1.

- Global inflation has continued to gradually ease – with our measure of consumer prices increasing by 5.8% yoy in May 2023, the slowest rate of increase since December 2021.

- Even so, further policy rate increases are likely by the major advanced economy central banks, although positive June CPI data has increased hopes that the US Federal Reserve is close to ending the current tightening cycle. In contrast, the outlook is more mixed for EM central banks, with some either having cut rates or soon expected to do so.

- Continued monetary tightening – and the flow through of past increases – will weigh on global growth. As a result, we expect the downshift in growth in Q2 to be sustained. The Global Composite PMI fell in June; the decline was broad based and included the first fall in the services PMI since late 2022.

- As a result, we continue to expect weak global growth in both 2023 and 2024. Our forecast for 2023 is unchanged at 2.8%, while 2.7% is expected for 2024 (previously 2.6%). That said, risks around the outlook have become more balanced, with economic growth showing continued resilience, lower inflation signalling less upside risk to policy rates, and the stress in financial markets (following banking issues earlier in the year) having receded. However, uncertainty remains about how far monetary tightening goes (and its impact), and there are still various geopolitical risks – such as from the continuing Russia/Ukraine conflict.

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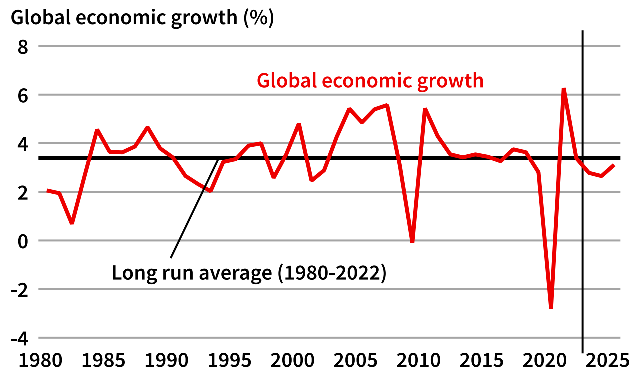
Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	1.6	0.6	1.8
Euro-zone	-6.2	5.3	3.5	0.5	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	0.5	0.9
Canada	-5.1	5.0	3.4	1.5	0.6	1.4
China	2.2	8.1	3.0	5.2	4.5	4.8
India	-6.0	8.9	6.7	5.6	5.7	5.9
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	2.7	0.6	0.2	3.0
Global	**-2.8**	**6.3**	**3.4**	**2.8**	**2.7**	**3.1**

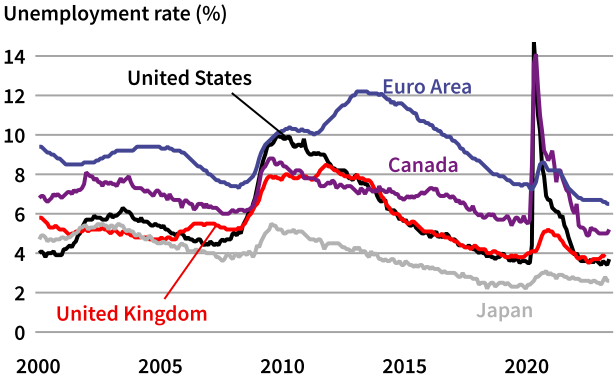
Weak global growth expected for 2023 and 2024



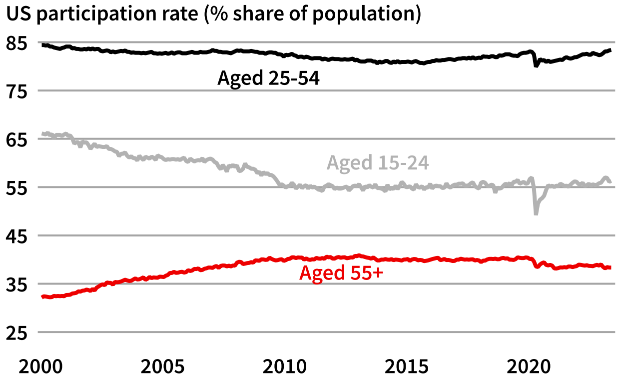
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: while labour markets remain tight across the advanced economies, trends in participation rates differ. Older age North American workers have increasingly left the labour force post-pandemic, while participation for this cohort has risen in Europe and Japan

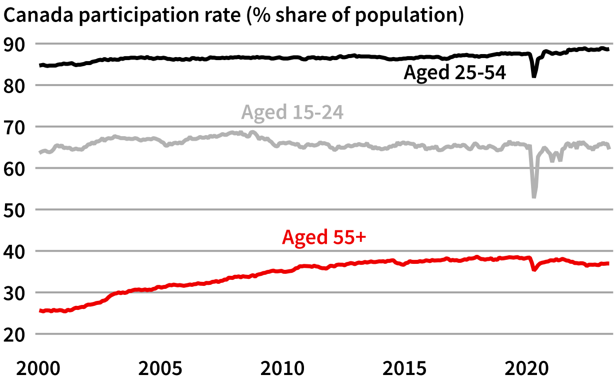
Labour markets in major advanced economies remain historically tight, despite a slowing trend in activity and rapid tightening in monetary policy (in most countries) since 2022



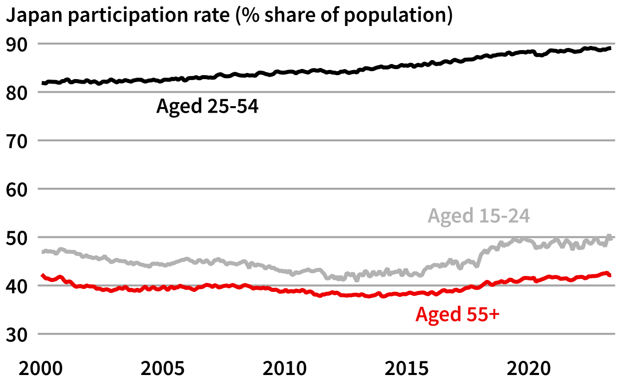
US participation for those aged 15-64 has only just recovered to pre-pandemic levels but remains below pre-GFC rates. Drop off in older aged participation (particularly workers aged 65 and older)



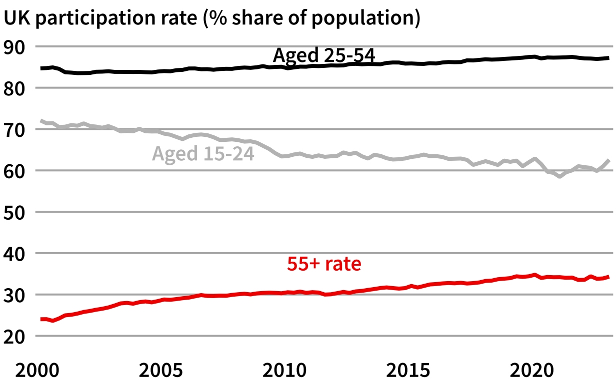
Canada's participation rate quickly recovered following the pandemic driven downturn, led by a rising trend among the core 25-54 age group. Similar to the US, older aged workers appear to be leaving the workforce



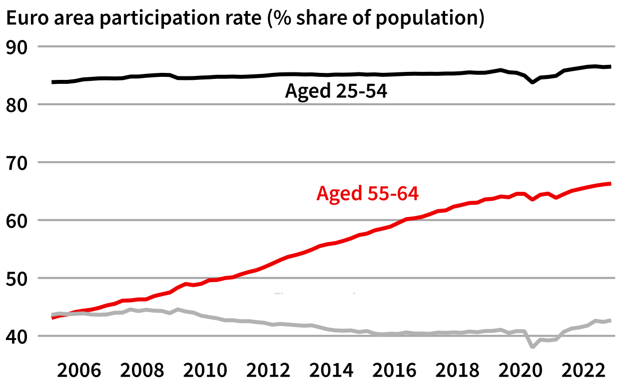
Pandemic triggered a brief, mild, dip in core working age participation in Japan, but longer run trend of higher participation among the prime and older aged group has subsequently continued



Post-pandemic dip in UK younger aged participation rate largely reflects compositional changes – with increased population at the lower end of this group (mostly students)



Participation in Europe has been generally trending higher over the past decade and a half, particularly among the older age cohort (55-64) – which is above pre-pandemic levels



Financial and commodity markets: inflation slowing but further central bank rate hikes likely

Global inflation has continued to gradually ease – with our measure of consumer prices increasing by 5.8% yoy in May 2023, the slowest rate of increase since December 2021. That said, inflation remains well above the targets of most major central banks, although US June CPI provided a positive downside surprise – with the monthly growth rate around the Fed's target level (on an annualised basis).

Further increases in policy rates are likely in the near-term. Despite pausing at its June meeting, the US Federal Reserve remains on a tightening bias – with various Fed speakers indicating that two further hikes may be necessary, most likely including July, and that rates may be sustained at their peak for some time.

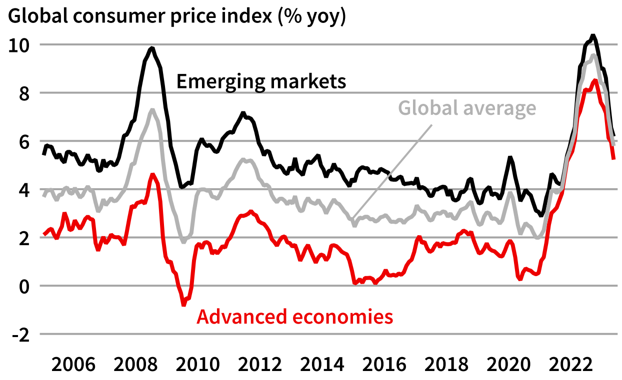
That said, markets (at the time of writing) are only pricing in around 30 basis points of increases to US rates by November, before starting to ease early next year. Markets anticipate larger rate increases by the European Central Bank – around 50 basis points out to December – but a similar easing pattern is expected from Q2 2024 onwards. Overall, the market priced profiles for US and European policy rates have shifted higher since early May but remain below the peaks of early March – prior to the banking sector fears that impacted both regions.

Similarly, government bond yields have generally pushed higher since mid-May, close to the levels recorded in early March. The key exception is the United Kingdom, where the 10-year government bond yield has climbed well above the recent cycle peaks, with yields in mid-July at their highest levels since late 2008. This reflects considerably stronger expectations of policy rate increases in the UK, given disappointing inflation data.

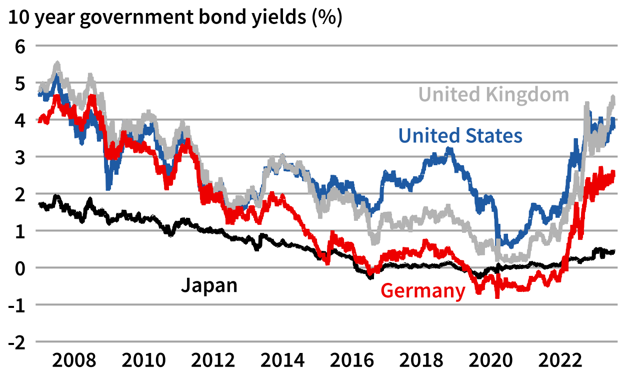
US equity markets continued to trend higher across June, with prices in early July reaching their highest level since April 2022. It is worth noting that these gains are not widespread – at the time of writing, the weighted average of the eight largest tech stocks on the S&P 500 had risen by over 30% since the start of May, whereas the rest of the index has declined by almost 10% over the same period. In part, the former reflects the current boom in artificial intelligence technology, while the latter reflects slowing in economic activity in the core of the US economy. Equity markets in other advanced economies and emerging markets have shown little to no gains since the start of 2023.

Commodity prices, measured by the S&P GSCI, have been relatively volatile since the second half of June, rising initially on market expectations of Chinese stimulus, and then again in early July – driven by energy prices. It is worth noting that the S&P GSCI has only recovered to levels seen in early March and remains well below the peaks of mid-2022. Prospects for commodity demand are not particularly strong – given the slower activity anticipated across the next 18 months.

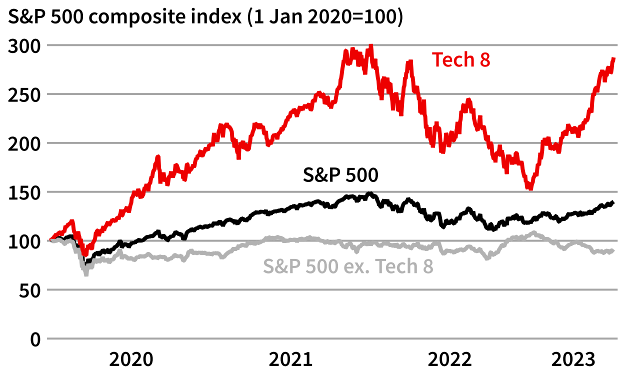
Global inflation coming down, but still relatively high



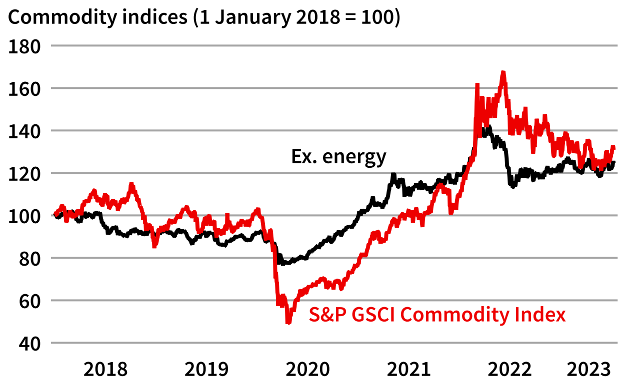
Bond yields generally trending higher



Upturn in US equities driven by tech stocks



Commodity prices edge up in early July



Advanced economies: growth holding up – but likely to remain subdued and rates still rising

Business surveys for June point to a deeper contraction in major advanced economy (AE) manufacturing. Our GDP weighted AE manufacturing measure has been below 50 (the break-even point) since late 2022, and a new low was reached in June. Offsetting this, the service sector rebounded over this period, but even this has started to fade, particularly in Europe. For the US, signals were mixed with the S&P Global PMI easing in July while the services ISM spiked higher, continuing its recent volatility.

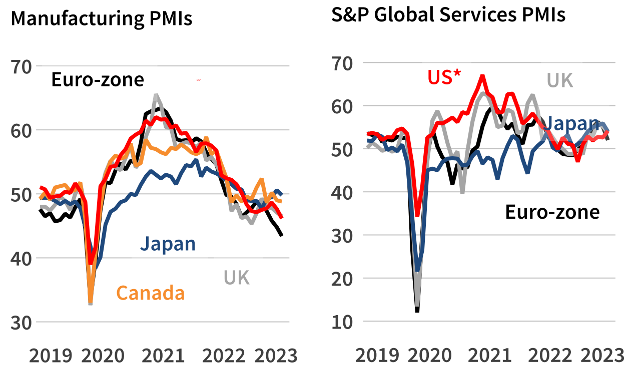
US Q1 GDP was revised up from 1.3% q/q (annualised) to 2.0% q/q. At the same time, recent partial data have been stronger than anticipated, and we now expect growth in Q2 of around 1¾% annualised (was 1.3%). As a result, our forecast for 2023 has been revised up. However, growth in consumption is slowing – after spiking in January, it only grew by 0.1% over the next four months.

Euro-zone data for Q2 is quite limited, but both retail sales and industrial production are tracking below their Q1 level. The PMI – which tends to provide a reasonable signal for GDP growth despite missing the (small) contraction in Q1 – is more positive. With the recent turn down in the PMIs for the region we have trimmed our short-term forecasts, but our view remains that there will be a period of subdued growth, as the boost from energy price relief is being offset by monetary policy tightening.

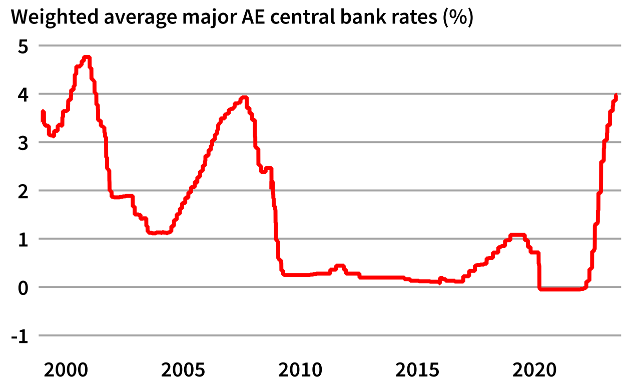
The tightening in monetary policy by the major central banks – ex. Japan – is not yet done, although some may be nearing the peak for this cycle. While the Fed is likely to raise rates later this month, we see them going on hold after this (with easing to start next year), with the softer June CPI result supporting this view. Similarly, while the ECB has flagged another increase at its next meeting, Euro-zone core inflation has trended down since February suggesting the peak in rates may be near. Even so, given the long lags involved, the full impact of past rate hikes has yet to be fully felt, and this underpins our soft growth outlook for the major AEs. The UK is a concern as core inflation has shifted higher recently and wage growth is also very high, raising the risk that the BoE could materially raise rates from here (which would depress the growth outlook); markets are pricing in over 100 bp in policy rate increases, well above what we expect to see.

Japan is an exception, as monetary policy has largely been on hold. While the global growth slow down (particularly on the goods side) has been weighing on exporters, this is being offset by the fall in energy prices and pent-up demand from the relatively late removal of COVID restrictions. Inflation has clearly moved higher, placing some pressure on the Bank of Japan to tighten policy. For now, the net result is an economy in an upswing – of the major AEs it is the only one where we expect growth over 2023 to be faster than it was in 2022.

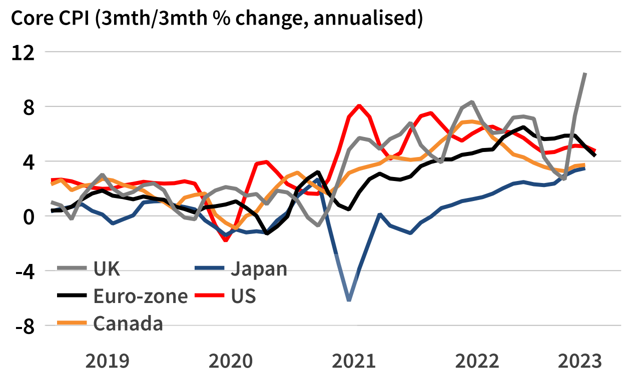
Surveys – services PMI turns down



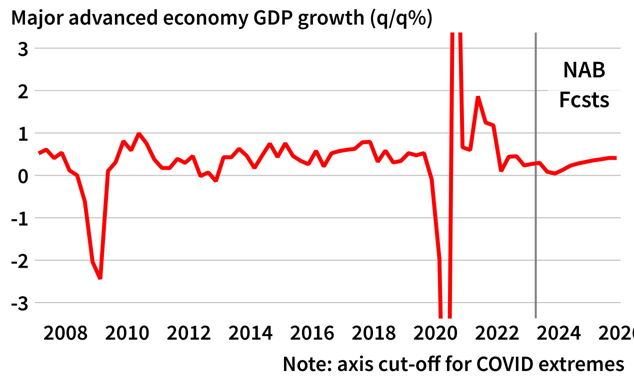
Rate tightening continues – full effects yet to be felt



Some welcome signs on inflation in US/EZ but needs to be sustained; UK a concern



Growth is expected to be subdued



Sources: Macrobond, Refinitiv, NAB Group Economics. * US PMIs an average of the S&P Global and ISM indicators; for other countries S&P Global

Emerging markets: China's latest GDP data point to a loss of momentum in Q2

Business surveys provide some of the most timely indicators of conditions in emerging markets. Overall, the EM composite PMI was softer in June, dropping down to a still relatively strong 53.6 points (from 55.6 points previously).

The key driver of this weaker result was the EM services PMI, which eased to 54.7 points (from 56.7 points in May) – reflecting weaker readings in both China and India (albeit India's measure remains at extremely strong levels by historical standards).

In contrast, the EM manufacturing PMI was only slightly softer – down to 51.1 points (from 51.4 points previously). Once again, China and India were the main contributors to this decline, although their respective levels are highly divergent, with India's reading strongly positive.

China's economy grew by 6.3% yoy in Q2 2023 (from 4.5% yoy in Q1), with the scale of this increase inflated by base effects. The second quarter of 2022 was significantly impacted by the strict lockdown in Shanghai, along with measures in Beijing and a range of other cities.

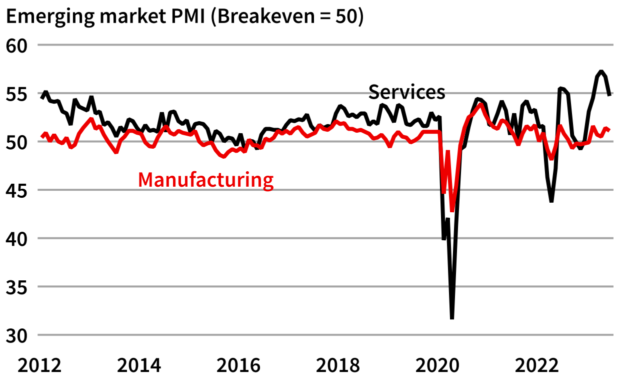
This means that the strength in year-on-year economic growth does not present an accurate picture of underlying conditions in China's economy. On a quarter-on-quarter basis, China grew by 0.8%, down from 2.2% in Q1, with various headwinds slowing its post-zero-COVID rebound. Consumer demand remains tepid (as evidenced by both retail sales and consumer prices), demand for credit has been soft (in part related to ongoing weakness in the residential property sector) and goods demand in major trading partners has continued to ease.

China is not alone with regards to the importance of trade – growth in emerging markets is typically more dependent on exports than is the case in advanced economies. The rapid lift in central bank policy rates and the rebalancing in consumption back towards services will continue to negatively impact growth in major EM exporters.

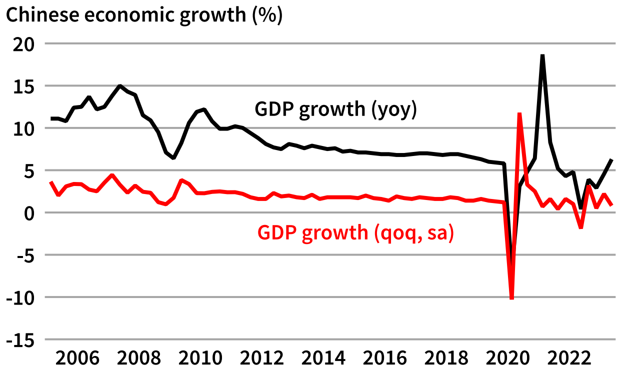
Global trade data compiled by the CPB show a slowing in volumes in April, following a surprise China-led spike in March. Export volumes were around 2.0% yoy stronger in April – led by strong growth in China (up around 11% yoy) however Chinese data showed that export volumes contracted marginally year-on-year in May.

On average, inflation in emerging markets has outpaced advanced economies – however this in part reflects the impact of some extreme outliers, such as Türkiye and Pakistan, where consumer prices rose by 38% yoy and 29% yoy respectively in June. In contrast, prices in East Asia (excluding China) rose comparatively modestly, peaking at around 5.4% in September 2022, and have now retreated below 3%. Vietnam's central bank cut its policy rate by 50 basis points in June, and other East Asian central banks may soon follow.

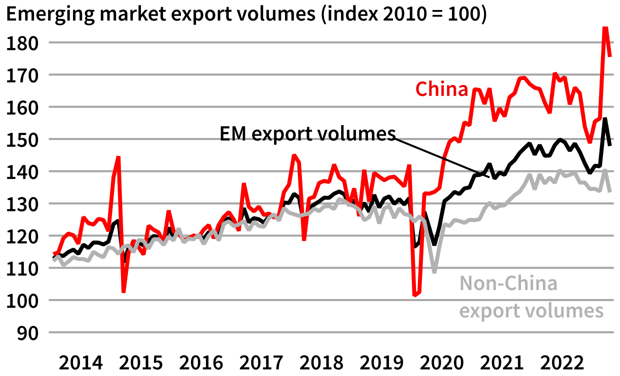
Services PMI weaker in June, pushing composite down



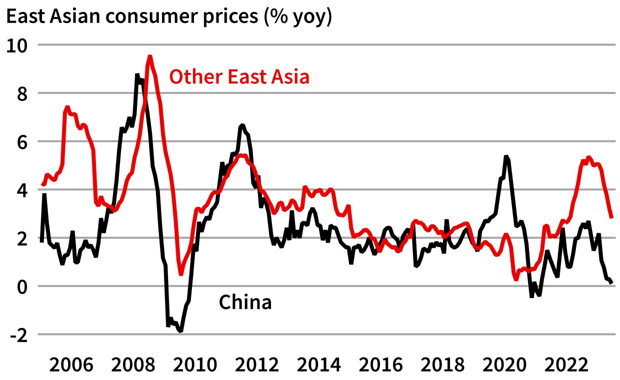
Weak qoq growth points to loss of China momentum



Export volumes down in April from March's spike



East Asian inflation has rapidly slowed in recent months



Global forecasts and risks: global growth looks to have slowed in Q2 and is set to remain weak

China was the first of the major economies to report Q2 GDP, foreshadowing a slowdown in global growth. This is despite the S&P Global Composite PMI survey being stronger (on average) in Q2 than Q1. The PMI over time correlates reasonably well with GDP (particularly in terms of direction) but quarter-to-quarter they can diverge.

This Q2 downshift in global growth is likely to be sustained. While the Global Composite PMI was higher in Q2, it fell in June (to 52.7 points, from 54.4). Manufacturing remains weak. More notably, the services sector PMI recorded a large fall –its first since late 2022. The fall in the PMI in June was also broad based across countries.

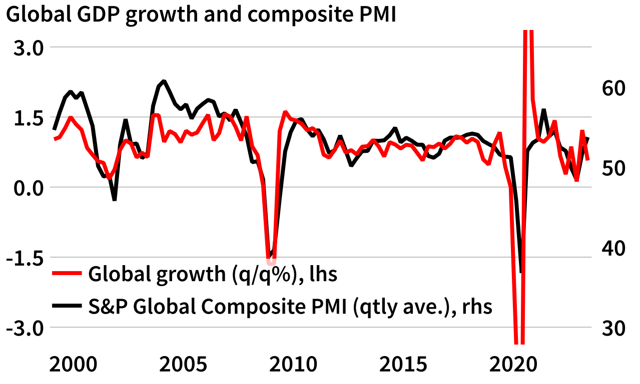
The likely slower growth in Q2 mainly reflects weaker EM growth – not only in China, but we expect also in India and Latin America – with major AE growth largely unchanged. Beyond Q2, growth in China is likely to remain below its historical average , reflecting a lower potential growth rate, ongoing consumer weakness and property market difficulties. For the major AEs, growth is expected to be soft (until 2025) as the full impact of monetary policy tightening works its way through.

Overall, our forecast for global growth in 2023 is unchanged at 2.8%, with a downward revision to China's growth offset by an upwards revision to the US forecast. Only small changes have been made to our 2024 forecast (+0.01ppts) but this is enough to push growth up to 2.7% (from 2.6%). 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 continue to expect a modest upturn in 2025 (to 3.1%).

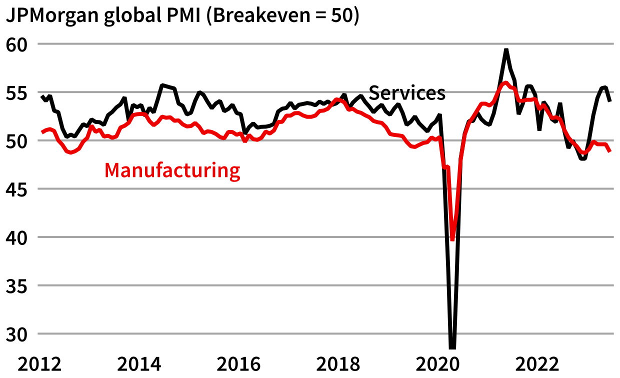
Risks around this outlook have become more balanced. As we have noted previously, a downside risk comes from AE monetary policy, and the potential for rates to rise further than expected (or stayer higher for longer) if inflation outcomes disappoint central bank expectations. The full impact (and timing) of the large increase in rates is also highly uncertain. There are still various geopolitical risks and, while a longer-term story (in terms of growth), growing impediments to trade and the risks that trading blocs emerge, are a concern.

That said, growth was generally resilient to a series of negative shocks last year, some of which have faded (e.g. commodity prices). This growth resilience, combined with some recent positive signs on inflation (particularly in the US) points to upside risk. Similarly, while the US bank failures earlier this year illustrate how quickly stresses can arise, the impact on indicators of global financial stress have been largely unwound. Concerns around the risk of EM economies being destabilised by capital flight have not been realised; indeed, while EM central banks were the first to hike rates there are expectations that some will soon cut rates (indeed Vietnam has already done so).

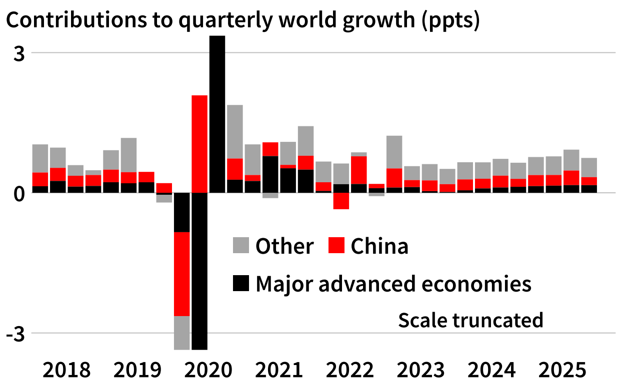
Global growth likely moderated in Q3 despite PMI signal



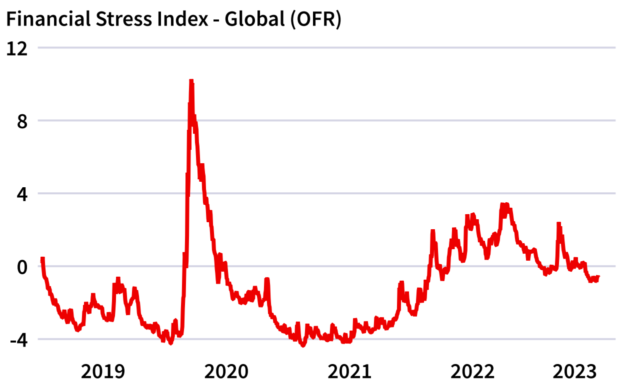
PMI turned down at end of Q2; services now fading



Major AE/China growth contributions to be soft



Financial system risks have receded (for now)



Sources: Macrobond, NAB Group Economics

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