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# The Forward View: Global August 2023

## Soft landing hopes rise but headwinds remain

NAB Group Economics

## Overview

- Global inflation continues to trend lower. Our global CPI indicator rose 5.3% yoy in June, its lowest reading since October 2021, and consumer prices in China slipped into deflation in July 2023. While commodity prices have trended higher since the start of June (led by energy), monthly core inflation for the major AEs in June was 0.2% m/m (as was US core CPI in July) pointing to underlying improvement.

- The easing in inflation pressures means that the global monetary policy cycle is likely getting close to its peak. Markets are not fully pricing any more increases in rates by the US Fed or the European Central Bank, while some EM central banks have started cutting rates (although further increases by some central banks, such as the Bank of England, are still expected).

- There was a broad-based pick-up in major advanced economy growth in Q2, underlining the resilience shown by these economies to a series of shocks last year. However, global growth likely eased with a slowdown in China and, we expect, a fall back from the strength in Q1 in some other EMs including India.

- Business surveys have turned down in recent months. Already weak manufacturing sector readings have edged down further while the global services PMI, which rose strongly through to May, has fallen back over the last two months.

- We have revised up our 2023 forecast to 2.9% (from 2.8%) but this remains low by historical terms, and we still see growth weakening further in 2024 (2.6%, previously 2.7%). This reflects several factors, including the full impact of past monetary policy tightening, with a tightening in bank lending standards underway, and that the world's largest economy – China – is struggling.

- That said, the chance of a soft-landing in the major advanced economies has increased, with inflation clearly falling even with stronger than expected growth. However, how far inflation falls is uncertain and labour markets remain tight, so further policy tightening remains a risk. There are also still geopolitical risks (e.g. the Ukraine/Russia conflict).

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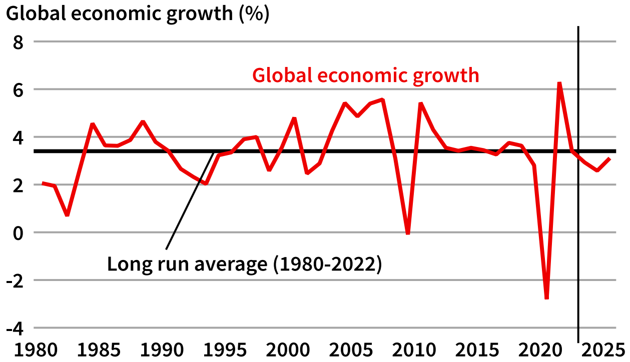
### Global growth forecasts

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|
| US | -2.8 | 5.9 | 2.1 | 1.9 | 0.6 | 1.8 |
| Euro-zone | -6.2 | 5.4 | 3.4 | 0.7 | 0.7 | 1.1 |
| Japan | -4.3 | 2.3 | 1.5 | 2.1 | 0.7 | 0.8 |
| UK | -11.0 | 7.6 | 4.1 | 0.5 | 0.6 | 0.9 |
| Canada | -5.1 | 5.0 | 3.4 | 1.7 | 1.1 | 1.6 |
| 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 | 3.9 | 1.8 | 1.3 | 1.9 |
| Other East Asia | -2.8 | 4.5 | 4.2 | 3.1 | 3.3 | 4.1 |
| Australia | -1.8 | 5.2 | 3.7 | 1.5 | 0.7 | 1.9 |
| NZ | -1.5 | 6.0 | 2.7 | 0.6 | 0.3 | 3.0 |
| Global | -2.8 | 6.3 | 3.4 | 2.9 | 2.6 | 3.1 |

### Below average global growth expected in 2023 and 2024





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

**Charts of the month:** financial markets quickly recovered from the impact of the banking system stress experienced in the US and Europe in March, with indicators of stress now lower than before. Bank lending standards have tightened although this started before the banking issues so how much can be explained by bank reaction to the failures vs a typical reaction to a growth slowdown and tighter monetary policy is unclear. Historically, tighter lending standards can lead to slower economic growth, and bank lending has slowed, but GDP growth has remained resilient (so far).

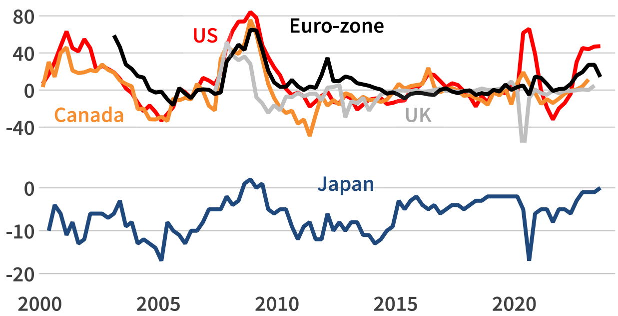
**Bank failures in the US (and pressure on, and the sale of, Credit Suisse) in March raised the prospect of global financial stress and a credit crunch…however, measures of financial stress are now below their pre-March levels**

Financial Stress Index - Global (OFR)


Source: Macrobond, NAB Economics

**Surveys of loan officers do point to a tightening of lending standards for business loans since March – but this was already underway and has not picked up speed**

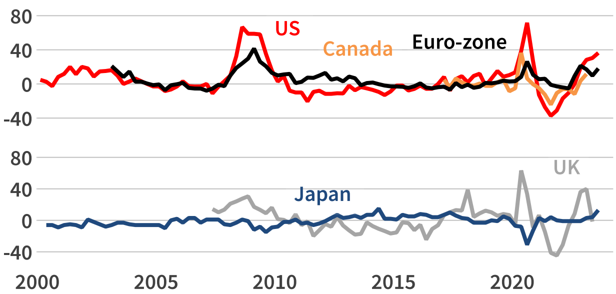
Net % of banks tightening lending standards- business loans*




* US domestic banks; UK availability of credit; Japan large firms

**Similar dynamics at play for loans to households, including consumer and mortgage (not pictured) loans**

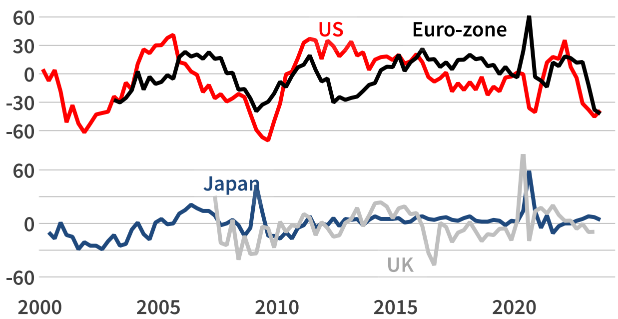
Net % of banks tightening lending standards - Consumer loans*




* US domestic banks, credit cards; UK availability of unsecured credit; Canada non-mort. lending

**Loan officers also reporting weaker demand for business loans (outside Japan)…and for household loans, although signs of stabilisation in most recent surveys;**

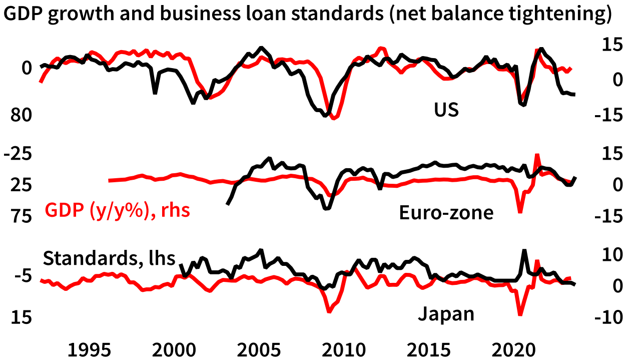
Net % of banks reporting stronger demand - business loans*




* UK - large PNFCs

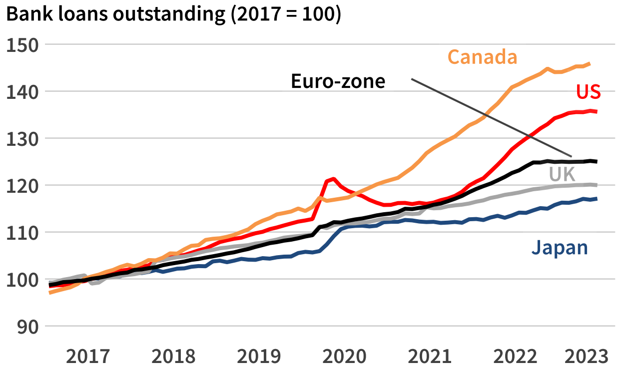
**Lending standards can lead a weakening in economic activity, although no. of historical episodes limited and less apparent impact this time around to-date**

GDP growth and business loan standards (net balance tightening)




**Tighter lending standards and reported falling loan demand reflected in clear slowdown in bank credit to households and businesses**

Bank loans outstanding (2017 = 100)




Sources: Macrobond, NAB Group Economics

## Financial and commodity markets: markets see policy rates near peaks as inflation retreats

Global inflation continues to trend lower – with our measure of consumer prices rising by around 5.3% yoy in June, the lowest rate of increase since October 2021. On average, inflation is softer among advanced economies – with prices increasing by around 4.5% yoy in June, however there is considerable disparity between these countries, with lower rates in Canada and the US (up by 2.8% yoy and 3.1% yoy respectively) and higher growth in the EU-27 and UK (6.4% yoy and 8.0% yoy respectively).

The slowdown in US inflation has lowered the likelihood of further policy rate rises from the Federal Reserve – despite some Fed speakers indicating that additional rate increases may be required. Following its July hike, markets are not fully pricing in any further hikes and anticipate an easing cycle commencing in March 2024.

Higher inflation in the Eurozone means a slightly higher probability of further rate rises – albeit markets only see around a 60% chance of a rate rise by December 2023 while rate cuts commence in mid-2024.

There is a greater risk that the Bank of England will increase rates further, with markets pricing in two further hikes, following the increase in early August. The other exception is Japan, which has only tightened policy marginally – most recently in late July when it effectively increased the cap on its yield curve target – although it is likely to continue to move cautiously.

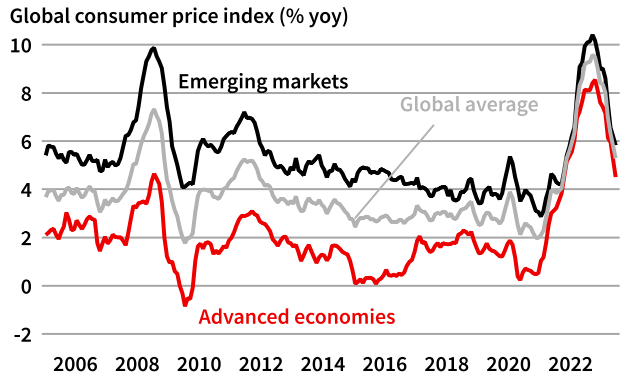
The tightening in bank lending standards and weaker loan demand in a range of advanced economies (see page 2) has added additional monetary tightening, reducing the extent to which central banks have needed to raise rates.

Equity markets – as measured by the MSCI indices – have generally trended higher since late May, with prices at the end of July up between 8% and 10% for the non-US advanced economies, emerging markets (EMs) and the US. That said, for the non-US and EMs, equity prices at the time of writing remained below levels at the start of the year and all markets are below early 2022 peaks.

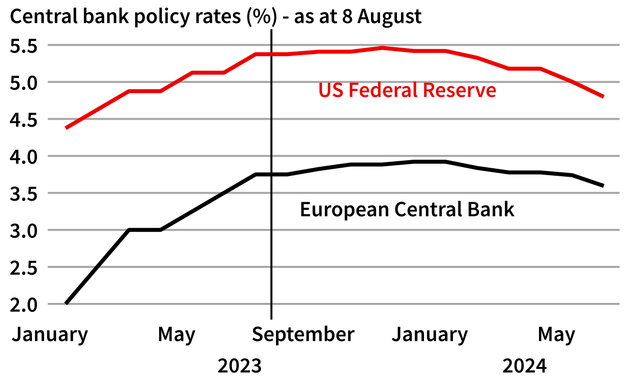
Recent trends in bond markets have been mixed. Yields on 10-year government bonds in the US have moved higher since mid-July, returning to the levels prior to March's banking sector jitters. In contrast, UK bond yields are slightly lower than their July peaks but remain elevated, while German bonds (as a proxy for the Euro-zone) have tracked broadly sideways since mid-April.

Commodity prices, as measured by the S&P GSCI, have trended higher since the start of June. This increase has been led by energy commodities, in part reflecting oil production cuts by OPEC+ members, whose output in July was its lowest since August 2021. In contrast, non-energy commodities have had brief rallies on expectations of Chinese stimulus, but subsequently retreated to similar levels to the start of June.

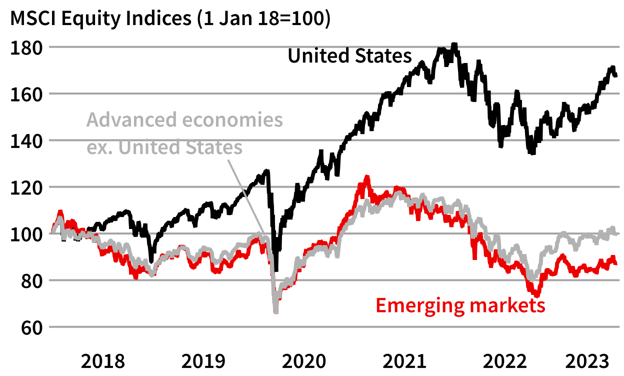
### Inflation continues to retreat but remains above target



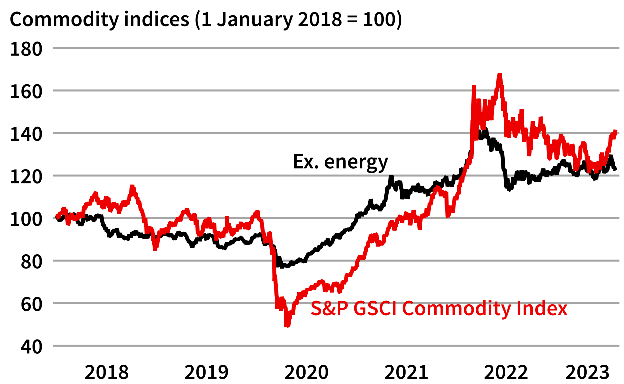

### Markets see policy rates at or near their peaks




### Equity markets have trended slightly higher since May




### Energy has driven commodity prices higher since June



## Advanced economies: growth generally improved in Q2, with Japan the standout

Initial estimates of Q2 GDP have now been released for the major advanced economies except Canada. Growth strengthened in the US, Euro-zone, UK and, in particular Japan, with only Canada likely seeing softer growth based on preliminary indications from the statistician.

For the US, growth has been solid over the last year, with Q2 boosted by stronger business investment, which helped offset weaker consumption. However, the boost in business investment was narrowly based and while surveys on future capex intentions have also improved a little in recent months, they are still at levels that point to softer outcomes ahead.

Euro-zone growth also picked up and the Q1 estimate was revised upwards from a small negative to a small positive. This means that the Euro-zone no longer qualifies as being in recession based on the two quarters of negative growth rule (but still suggests the economy basically stalled over Q4/Q1). We had expected some improvement in Q2 due to falling energy prices. To what extent this would be offset by further rate hikes and weakness in export markets was a source of uncertainty. In this light, the recent weakening in business surveys is a concern.

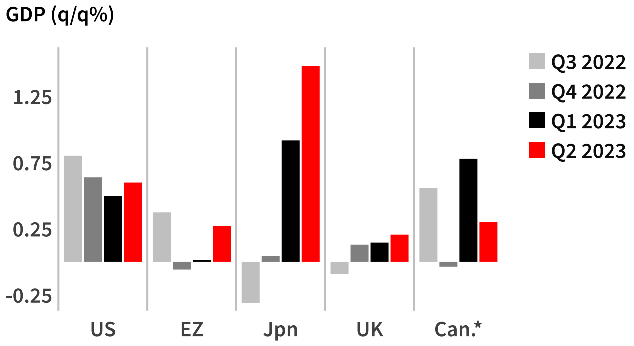
Similar competing forces are also at play in the UK (but with stronger inflation and tighter monetary policy pointing to weaker prospects). GDP growth was 0.2% in Q2 and GDP was only 0.4% higher than it was in Q1 2022. Moreover, as with the Euro-zone, the business surveys have also weakened in recent months.

Growth in Japan accelerated to a stunning 1.5% q/q, the fastest quarterly growth recorded since 2015 (outside the 2020 COVID rebound). GDP in Japan is now back above where it was prior to the October 2019 VAT increase and subsequent COVID shock. However, the details were less positive as domestic final demand declined, with net exports driving the result (and unlikely to be sustained).

Since the end of 2021, the US, Euro-zone, UK and Japan have all experienced one or more quarters of negative growth, and outside of these periods of subdued growth (except for the US). Despite this, there has been little or no upwards move in unemployment rates. At this stage, the adjustment is occurring through an easing in job vacancies. Vacancies are still generally high but they have fallen over 2022 and 2023.

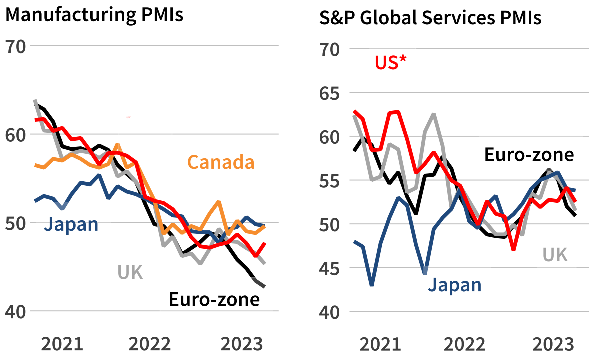
Resilient labour markets, particularly given the growing likelihood that we are nearing the peak of the monetary policy tightening cycle (at least outside of Japan which hasn't really started), raises hopes of a soft landing across the major AEs. While we expect growth in Europe is likely to be subdued, and we still think the US is still likely to see a modest correction, risks around the outlook have clearly become more balanced.

### Q2 growth stronger, including a surge in Japan

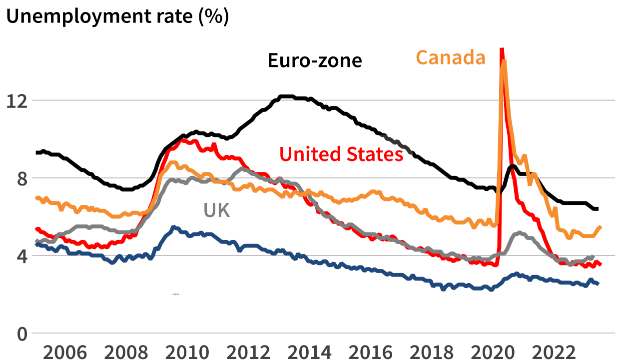



Source: Macrobond. * Canada Q2'23 is a NAB forecast

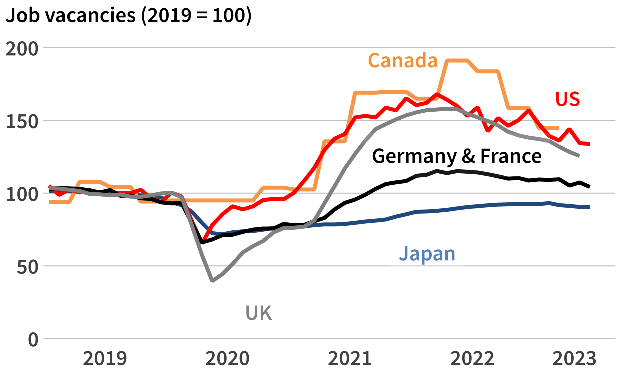
### Manufacturing still weak and services now turning down




### Unemployment rates still very low




### Job vacancies also high (ex Japan) but easing




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 has slipped into deflation as recovery has lost momentum

Emerging market business surveys were marginally softer in July, with the EM composite PMI easing to 53.0 points (from 53.5 points in June).

The key contributor to this trend was the manufacturing sector – with the EM manufacturing PMI down to 50.2 points (from 51.1 points previously). This downturn was driven by China, where the manufacturing PMI moved from a slightly positive reading in June to a negative 49.2 points.

In contrast, the EM services PMI was only marginally softer in July – down to 54.6 points (from 54.7 points previously). Trends were highly divergent among the major EMs, with a substantial strengthening in India's PMI, along with a slight uptick in China not enough to offset other countries, with Brazil and Russia both notably weaker.

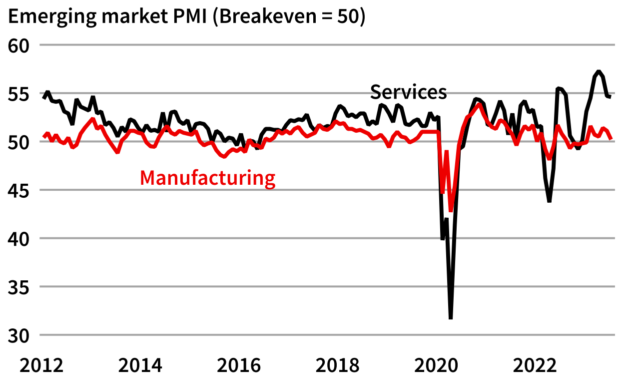
The stronger reading for China's services PMI was somewhat at odds with other indicators – including weak domestic consumption readings and inflation data, with consumer prices slipping into deflation in July 2023 (in stark contrast to the broader global trend). In addition, producer prices have contracted since late 2022. These data point to the loss of momentum in China's post-zero-COVID recovery – with domestic demand remaining subdued. Despite officials touting various possible measures to provide stimulus, policy makers remain reluctant to provide consumption boosting support to households.

Preliminary data for other East Asian economies suggests that growth was stronger in Q2 – up by 1.5% qoq (from 0.8% qoq in Q1 – driven by a surge in Indonesia, while Taiwan recovered following a recession recorded over the previous two quarters. That said, growth remained relatively weak for the region in year-on-year terms – up to around 3.0% – compared with an average of around 4.3% yoy since 2000.

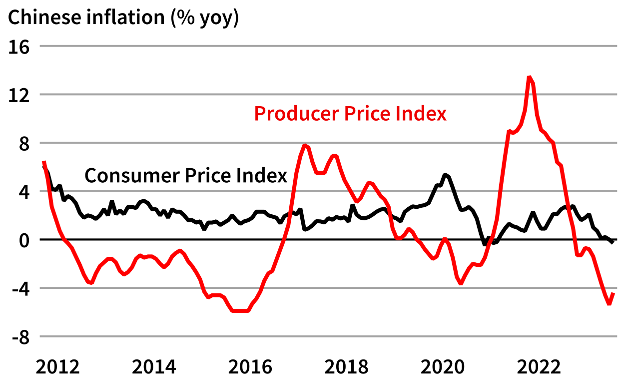
Global trade data shows that EM export volumes contracted by 0.8% yoy in May, with volumes having retreated in recent months from the unexpected, China-led spike in March. China Customs data suggest that the decline in export volumes accelerated in June. This deteriorating trend in EM exports is consistent with our expectations – given the impact of tighter monetary policy and the rebalancing of consumption towards services on goods demand in advanced economies.

According to IIF data, emerging markets have attracted increasing capital flows in recent months, in stark contrast to several months of aggregate outflows between early 2022 and March 2023. When compared with trends prior to 2022, China has accounted for a smaller share of capital inflows, in a large part reflecting investor flight from the country's debt markets.

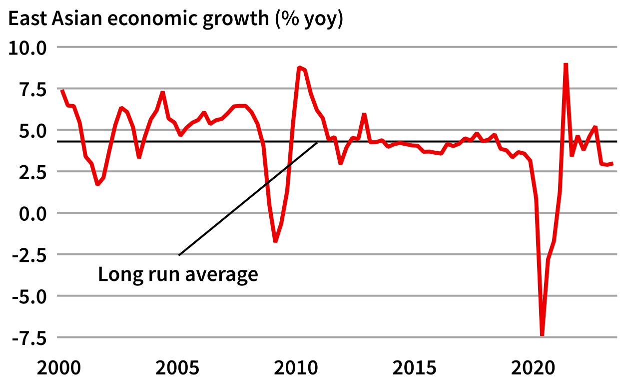
### Manufacturing drove weaker business surveys in July



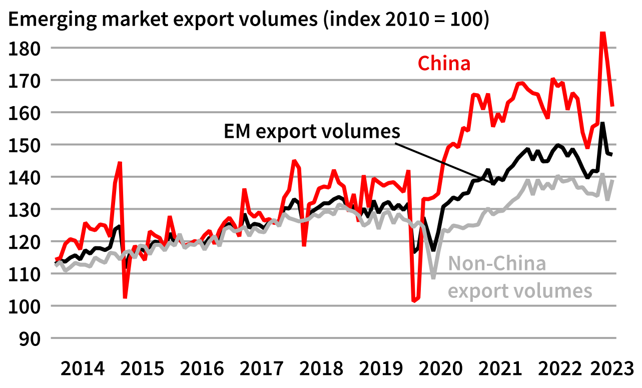

### China slipped into deflation in July




### East Asian growth remains below trend




### EM export volumes have retreated from the March spike



## Global forecasts and risks: global economy resilient as inflation falls, but outlook still subdued

Incoming Q2 GDP data are consistent with our view that world growth slowed in the quarter. A key driver is slower Chinese growth, with only a short-lived boost from removing COVID restrictions, but we also expect India's and Latin America's Q1 strength will not be sustained. In contrast, AE growth in the quarter was stronger than in Q1.

Despite this downshift in Q2, the resilience of the global economy has been notable. While western Europe clearly stalled for a period, growth picked up in Q2. Illustrating this resilience, this month we have further revised up our global forecast for 2023 to 2.9%, from 2.8% last month and as low as 2.6% (in March). This month's change reflects higher forecasts for a range of countries and regions, including the US, Japan, Euro-zone and Russia.

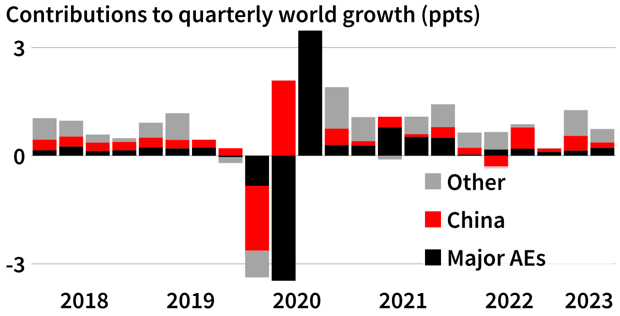
A welcome development has been the generally lower inflation readings in the major economies. GDP weighted core monthly CPI inflation for the major AEs in June was 0.2% m/m (as was US core CPI in July), its lowest level in almost a year, and China is now deflating. There is increasing confidence that policy interest rates in the major AEs are nearing their peak (see page 3). Similarly, while some EMs are still raising interest rates (such as Russia and Türkiye), others are either on pause or are cutting (e.g. Vietnam, Brazil, Chile).

We still expect to see weak global growth in 2024 (2.6%, previously 2.7%). This reflects, in-part, the long lags between monetary policy changes and their full impact, with a tightening in bank lending standards underway (see page 2). While energy prices are well off their peaks, they remain above their pre-pandemic level. The adjustment that this will lead to (across industries and regions) will likely be disruptive and may explain why European manufacturing has shown little improvement even as energy costs have fallen back. Moreover, the world's largest economy (on a PPP basis) – China – is struggling, with renewed property market stress and risk of contagion to other sectors (including investment trusts).

Consistent with this, business surveys have turned down in recent months. Already weak manufacturing sector readings have edged down further while the global services PMI, which rose strongly through to May, has fallen back over the last two months.

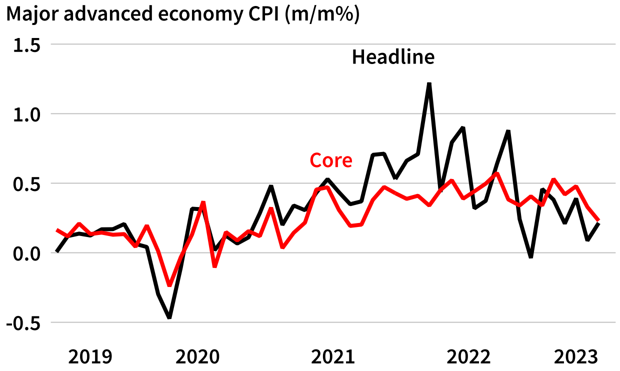
Overall, this suggests that risks around outlook are balanced. Lower inflation, with growth holding up, increases the chance of a soft-landing. Against this, advanced economy labour markets remain very tight, which could trigger further policy tightening. Moreover, energy prices appear to have bottomed out; oil prices (which feed into consumer prices more quickly than gas prices) have increased almost 20% since the end of June. As a result, the drag on headline inflation from this source is set to fade. There are still various geopolitical risks – including the Ukraine/Russia conflict.

### Global growth likely moderated in Q2

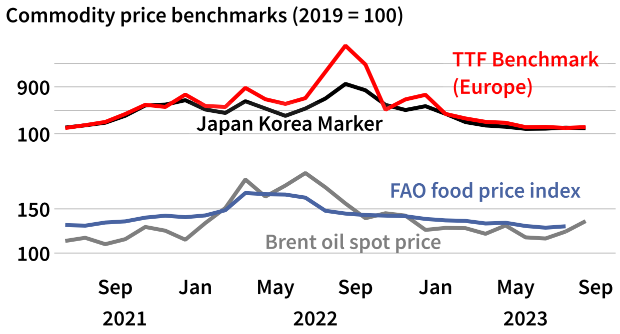



Sources: Macrobond, NAB.Q2 '23 mix of actuals and NAB fcsts. Scale truncated.

### Favourable inflation developments in recent months

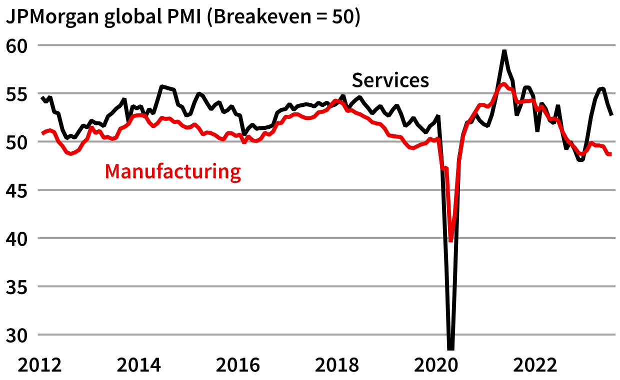



### But energy prices may have bottomed out?




Source: Macrobond, NAB

### Not out of the woods- business surveys turning down



# 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

## 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

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