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The Forward View: Global Sept 2023

Central banks may be at their peaks, but energy prices pose a risk to disinflation trend

NAB Group Economics

Overview

- Global inflation accelerated in July – ending the trend of disinflation exhibited over the previous nine months, albeit this largely reflected an uptick in India and Türkiye, rather than a broad-based increase. Inflation among advanced economies continued to ease – edging down to 4.4% yoy.
- The slowing inflation trend in advanced economies has increased the likelihood that most major central banks have either reached the end of their tightening cycle or are near the peak. That said, this assumption is predicated on inflation continuing to trend lower (with rising energy prices a risk to headline inflation), and near-term risk around policy rates is still to the upside. There is considerable uncertainty around when central banks will start to cut rates.
- Momentum across the major advanced economies was mixed in Q2 – with economic growth solid in the US and Japan but more modest in the Euro-zone and UK. These mixed signals have continued into Q3, though we expect a more general slowing from Q4 and across 2024.
- Similarly, we have seen differing trends in the two largest emerging markets – China and India. Weak domestic demand and growth headwinds are buffeting China's economy, while India has been stronger than anticipated – however El Nino could negatively impact the latter going forward.
- We have revised up our global growth forecast for 2023 to 3.0% (from 2.9%). This reflects an upgrade to India that more than offset a small downward revision for China. For 2024 we expect growth to be even weaker (at 2.6%), particularly in the AEs, before a recovery in 2025 to 3.1%, assisted by an easing in monetary policy. This outlook is weaker than the long-term average of 3.4% (since 1980).
- Risks around the outlook have become increasingly balanced, however, much will depend on the path of inflation and central bank patience (particularly as energy price risk is re-emerging) along with various geo-political pressures (Russia-Ukraine conflict and US-China tensions).

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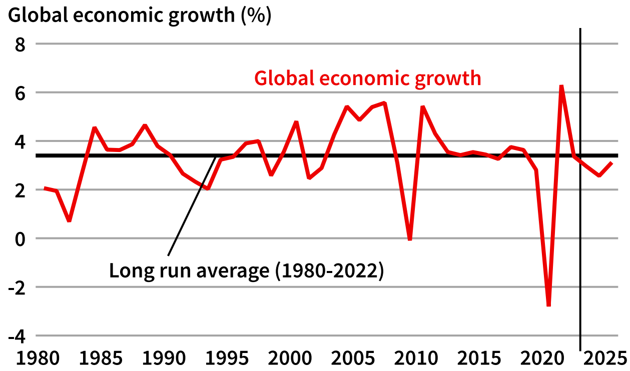
Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.8	5.9	2.1	2.1	0.8	1.7
Euro-zone	-6.3	5.6	3.4	0.5	0.6	1.1
Japan	-4.3	2.3	1.5	1.9	0.7	0.8
UK	-10.4	8.7	2.5	0.4	0.6	0.9
Canada	-5.1	5.0	3.4	1.4	1.3	1.6
China	2.2	8.1	3.0	5.0	4.5	4.8
India	-6.0	8.9	6.7	6.3	5.2	6.2
Latin America	-6.8	7.0	3.9	2.0	1.4	1.9
Other East Asia	-2.8	4.5	4.2	3.0	3.3	4.1
Australia	-1.8	5.2	3.7	1.8	1.1	2.2
NZ	-1.5	6.0	2.7	0.8	0.3	3.0
Global	**-2.8**	**6.3**	**3.4**	**3.0**	**2.6**	**3.1**

Global growth to remain below average across our outlook to 2025

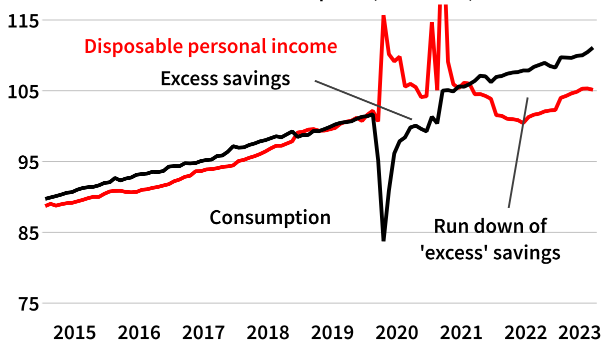


Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

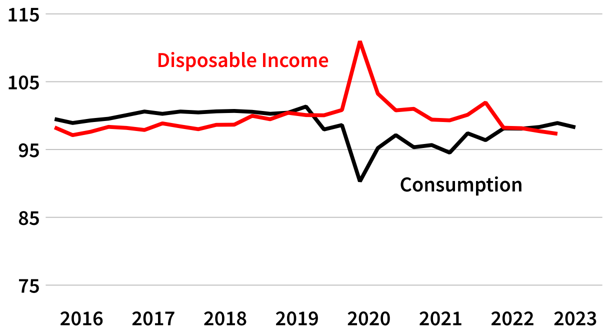
Charts of the month: As household spending power came under pressure from high inflation and rising interest rates, a question was to what degree households would dip into the 'excess savings' (savings above their pre-pandemic trend) accumulated during the pandemic. So far, households in countries where pandemic-era policy support for incomes was greatest have been more willing to utilise these savings (Canada is an exception but has seen a smaller real income squeeze). In contrast, where policy largely maintained income (in Europe), savings rates have come back to their pre-COVID levels with households retaining their 'excess' savings. It may also be that, despite the energy price shock, real incomes have more drifted sideways and energy/war concerns may have made households more cautious.

Covid real income lift & recent use of 'excess' savings

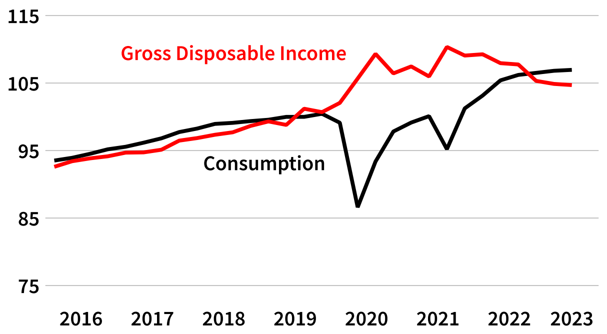
US real h'hold income and consumption (2019 =100)



Japan - real h'hold income & consumption (2019 = 100)

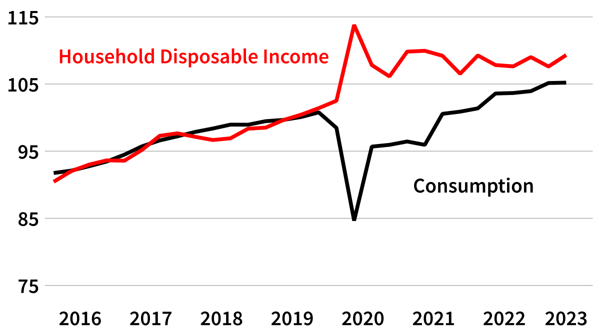


Australia - real h'hold income & consumption (2019 = 100)



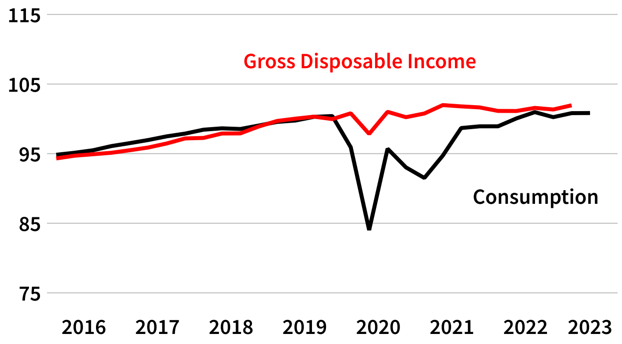
Canada exception – continuing to build 'excess' savings

Canada - real h'hold income & consumption (2019 =100)

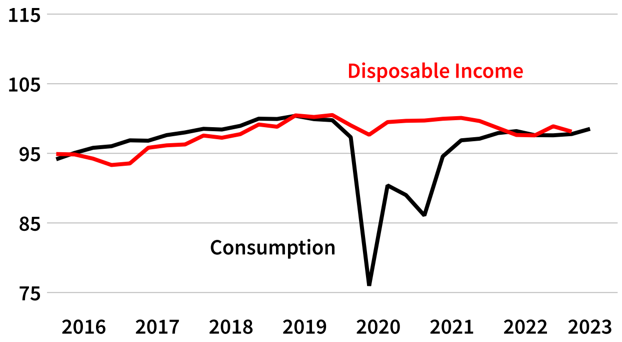


UK & Euro-zone policy kept income around pre-COVID levels – households not utilising 'excess' savings

Euro-zone - real h'hold income & consumption (2019 = 100)

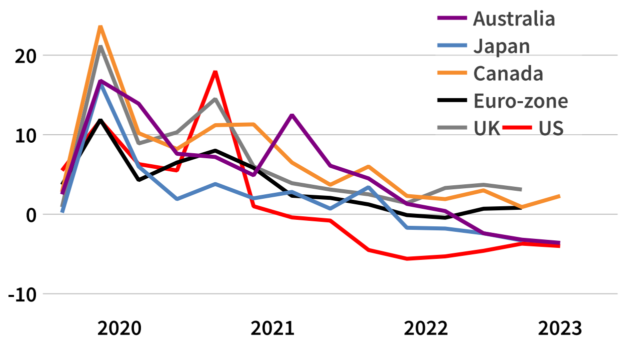


United Kingdom - real h'hold income & consumption (2019 = 100)



Savings rates have shown a similar pattern across countries – rising in the pandemic (particularly lockdown periods) and then declining; and in the US, Japan and Australia they are now below their pre-pandemic level

H'hold savings rate (ppt deviation from Q4 '19)



Sources: Macrobond, NAB Group Economics

Financial and commodity markets: most major central banks may have reached their peaks

Our measure of global inflation accelerated to 6.4% yoy in July 2023 (from 5.8% yoy in June), ending the trend of disinflation exhibited over the previous nine months, following the cycle peak recorded in September 2022. This trend was driven by emerging markets – particularly India and Türkiye, with inflation in the latter rising to 47.8% yoy in July. In contrast, inflation among advanced economies (AEs) continued to ease, edging down to 4.4% yoy in July (from 4.5% yoy in June).

That said, inflation trends among major AEs remain mixed. While disinflation has been more rapid in recent months in North America, there was a slight uptick in both the US and Canada in July (both up to around 3.3% yoy). In contrast, inflation in the EU and UK has been comparatively higher in recent months but moderated in July, down to 5.3% yoy and 6.8% yoy respectively.

The easing in inflation across advanced economies has increased the likelihood that most major central banks have either reached the end of their tightening cycle or are near the peak. We believe that the Fed has finished hiking, consistent with market pricing, while the ECB has indicated that rate hikes might have ended, following a 25 basis point increase in mid-September. While Bank of England rates may also be near their peak, wages growth and inflation remain comparatively strong in the UK, which may force further action.

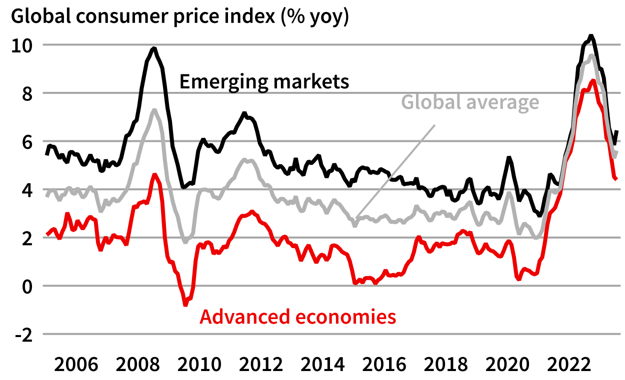
The assumption that central banks have finished tightening is predicated on inflation continuing to ease, with near-term risk around policy rates mostly to the upside. There is considerable uncertainty around when central banks will start to cut rates.

A key source of downward pressure for headline inflation since early 2023 has been falling energy prices, however this is starting to reverse. As measured by the S&P GSCI, energy commodity prices fell between early June 2022 and early May 2023. However, energy prices have been trending higher since the end of June, with the energy index rising in early September to its highest levels since November 2022. In contrast, non-energy prices have not seen anywhere near the same level of volatility.

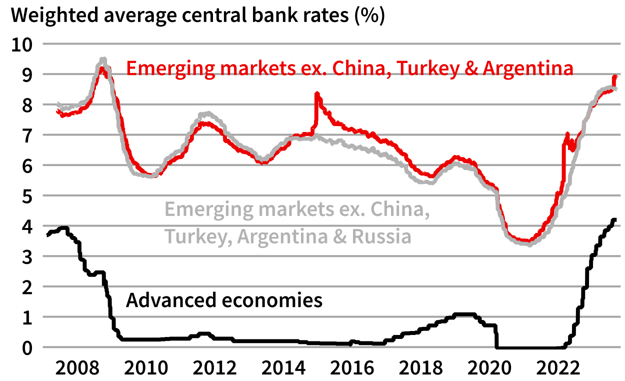
In part, the uptick in energy prices reflects discipline from OPEC+, which cut its oil production by around 5.4% between October 2022 and July 2023, initially in an attempt to put a floor under global crude prices and then drive them higher.

Global equity market indices have followed a broadly similar path in recent times, retreating from their relative peaks in late July before a partial recovery between mid-August through early September and a subsequent correction. Some analysts attributed this volatility to uncertainty around China, particularly following the near default of property developer Country Garden.

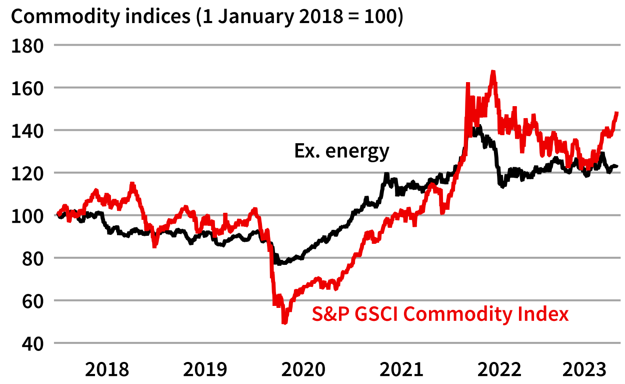
EMs drove global inflation higher in July



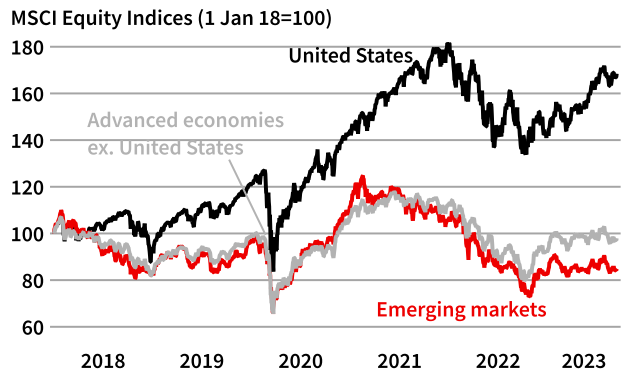
Major central banks appear close to their peaks



Energy driving the recent surge in commodity prices



Equity markets off late July peaks



Advanced economies: Growth in US and Japan holding up; weak in Western Europe & Canada

Momentum across the major advanced economies has been mixed of late. As noted previously, economic growth remained solid in the US and was very strong in Japan in Q2. Growth was more modest in the Euro-zone and UK but showed improvement on Q1.

In contrast, Canada saw a small decline in GDP – for the second time in three quarters. Over time, Canada GDP growth tends to follow the US but the recent relative weakness can be partly explained by the fall in energy prices over the last year and the impact of bushfires.

The mixed signs have continued into Q3. Early US data for the quarter have been strong. Household consumption grew by 0.6% m/m in July, following on from 0.4% m/m in June. That said, business surveys remain mixed but overall soft, and the strength in consumption appears unsustainable – with a correction likely. Due to the strength in early Q3 data we recently revised up our forecast for US growth in 2023, but still see a material slowdown in growth from here, including a small contraction in GDP at some point.

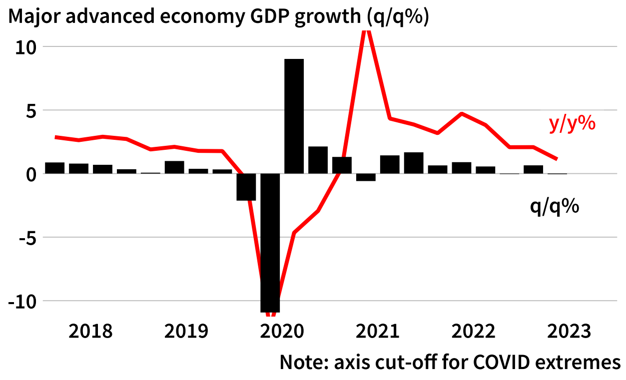
Incoming data for Western Europe have been decidedly on the weak side. Euro-zone retail sales (-0.2% m/m) and industrial production (-1.1% m/m) both fell in July. UK July monthly GDP fell 0.5% m/m; this was probably partially due to an unwind of the June strength (+0.5 m/m), poor weather and strikes, but even so a weak result.

There has also been a clear deterioration in the business surveys for both the UK and Euro-zone over recent months. For the Euro-zone, the PMIs generally provide a reasonable guide to GDP growth – and are currently signalling a Q3 downturn absent better September readings. We have lowered our near-term forecasts for both the UK and Euro-zone, but our underlying view that growth is likely to be weak as the gains from the pull-back in energy prices are offset by the impact of rising interest rates (and soft global growth) is broadly playing out.

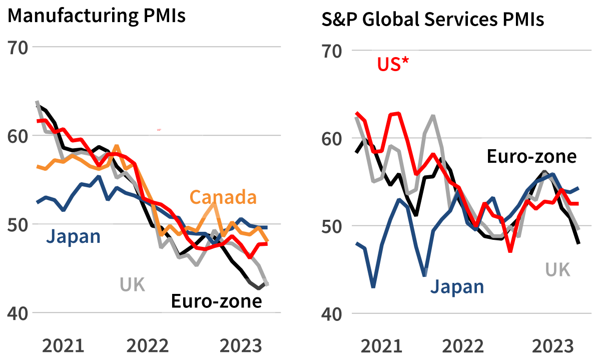
Q2 GDP growth in Japan was revised down from 1.5% to 1.2% q/q – still well above what would normally be expected in a full year on a trend basis. However, domestic final demand fell, in part due to the drag on consumption from the squeeze on real household incomes. We expect Q3 to be flat – as a correction to the Q2 data rather than a view on any underlying weakness. With post-COVID normalisation still underway, and a boost coming from the fall in energy prices (even with recent increases), the near-term outlook is positive, as can be seen in the PMIs for Japan, which are outperforming the other major AEs.

Labour markets remain tight, but the weakness in growth in the UK and Canada is now being reflected in a small upwards move in the unemployment rate. Outside of these countries, job vacancies are falling, suggesting some easing in labour market pressure.

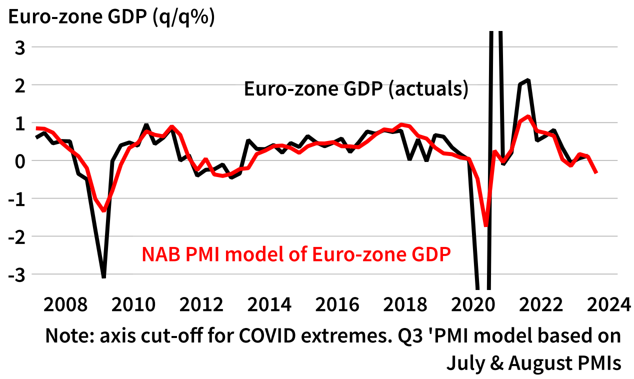
Canada GDP – small fall in Q2 2023



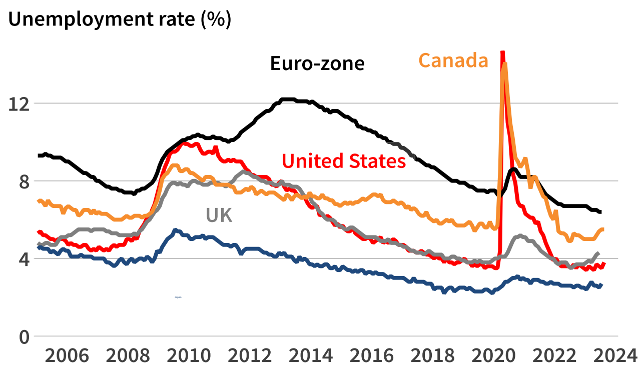
Business survey soft – particularly western Europe



PMIs signalling weak Q3 GDP in Euro-zone



Labour markets still tight, but signs of 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: differing trends in two largest EMs, with India stronger in Q2, China weaker

Business surveys provide some of the most timely indicators of conditions in emerging markets. The EM composite PMI continued to ease in August, down to 52.7 points (compared with 52.9 points in July).

Trends were divergent between individual sectors – with the EM manufacturing PMI trending higher in August, up to 51.4 points (from 50.2 points previously). Although all major emerging markets were stronger in August, the increase was driven by a large uptick in China – a trend that was only present in the private sector Caixin survey and not the official NBS measure. Reflecting the differing composition of respondents to these surveys, this may indicate that improving conditions are not broad-based.

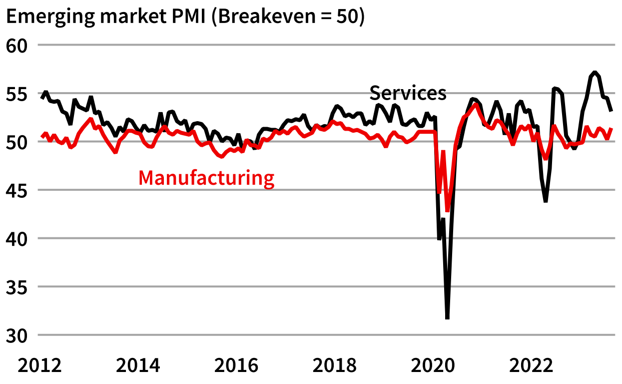
In contrast, the EM services PMI continued to soften – down to 53.1 points in August (from 54.5 points in July). This reflected weaker readings in China and (to a slightly lesser extent) India, albeit India's reading remained firmly in positive territory.

India's economy grew more rapidly than anticipated in Q2 – increasing by 7.8% yoy, albeit seasonally adjusted quarterly growth was marginally softer than in Q1. Given the rapid increase across the first half of 2023, we have revised up our forecast for India's full year growth – that said, we have done so cautiously, given existing drought conditions that will likely worsen due to the emerging El Nino event. This could drive inflation higher and trigger intervention by the Reserve Bank of India. Reflecting this we have slightly cut our forecast for 2024.

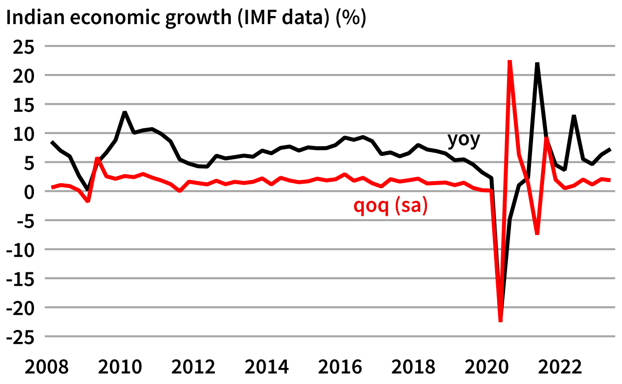
In contrast to the upgrade to this year's forecast for India, we have slightly trimmed our growth forecast for China – down to 5.0% for 2023 (in line with the government's growth target), from 5.2% previously. The deteriorating conditions in the property sector and weakening external demand remain headwinds, while domestic demand appears to remain subdued. Chinese authorities have resisted implementing major stimulus, instead implementing modest relaxation of monetary policy across the year (such as increasing liquidity by reducing required reserve ratio for banks in September) that has so far had little impact due to weak loan demand.

Economic growth in emerging markets is generally more export dependent than is the case for advanced economies. Following the unexpected spike in export volumes in March 2023 (which may have reflected a catch up in deliveries following several weak months prior), EM export volumes have continued to drift lower – down by 2.6% yoy in June. China's official trade index showed further weakness in July – with export volumes down by almost 4% yoy. EM exporters continue to face deteriorating conditions in advanced economies – reflecting the impact of tighter monetary policy and the rebalancing in consumption back towards services (following the shift to goods during the pandemic).

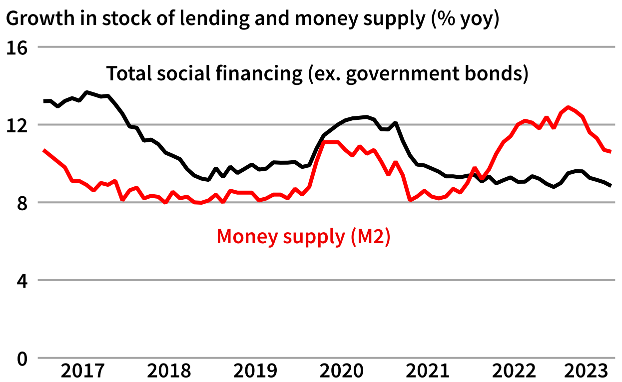
Drop in services outpaced upturn in manufacturing



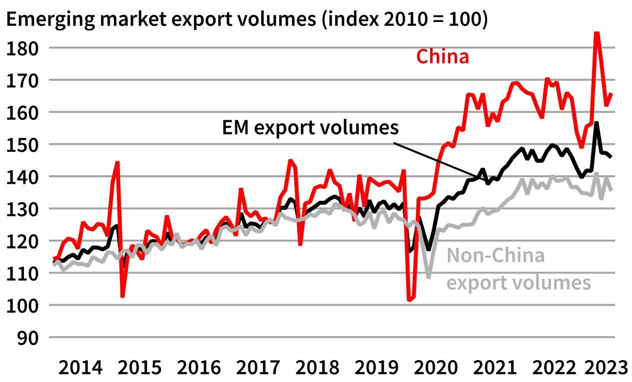
India performed strongly in H1, but El Nino a risk



China's loan supply already outpacing demand



EM export volumes drifting lower



Global forecasts and risks: global cross-currents set to keep growth slow

The JP Morgan composite global PMI fell for the third consecutive month in August and is at its lowest level since January 2023. The August fall was driven by the services PMI, with the manufacturing PMI up slightly although it remains weak. The fall in the services PMI was broad-based across the advanced economies while a fall in China dragged the EM measure down.

The manufacturing PMI has now been below breakeven since September 2022. Global industrial production has been impacted by a switch back to services as activity has normalised and growth slowed and, in some sectors, a correction in inventory levels. This dynamic was evident in the tech sector, but there are signs that tech production has lifted in some locations, while in Taiwan inventories have fallen (as exports have stabilised), a precursor for production stabilising.

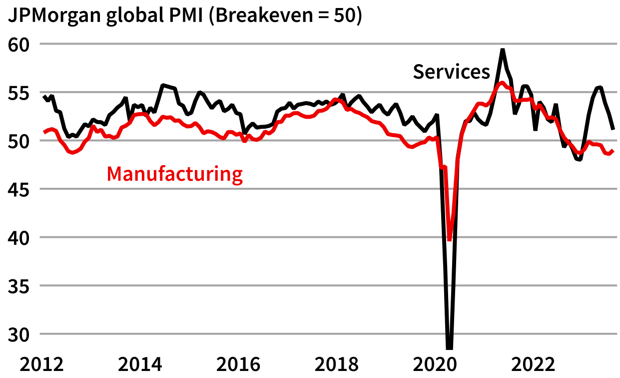
The swings in tech production are symbolic of the big forces (and swings) that have been impacting the global economy. Similarly, a large part of the run up in commodity prices (particularly for gas) in 2022 has been unwound. At the same time, monetary policy has continued to tighten. While we think the monetary tightening cycle is near its peak, rate rises affect activity with a lag and will continue to weigh on growth into next year. On top of this, China is facing some internal headwinds, particularly in its property sector.

The net result of these cross currents is likely to be slow global growth, by historical standards, over coming years.

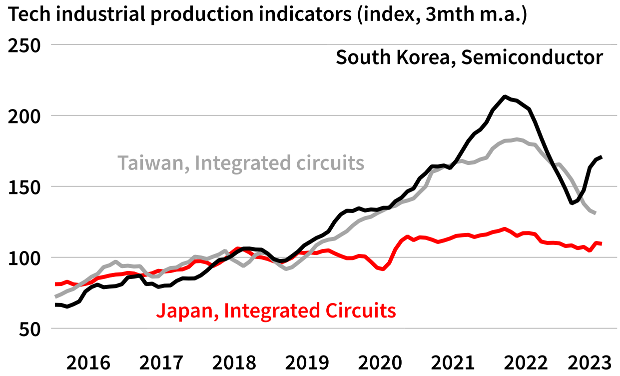
For 2023, we have revised our global growth to 3.0% (from 2.9%), as India Q2 growth exceeded expectations. This more than offset a small downward revision for China. Among AEs, there were mostly small downward revisions, but these were offset by a lift in expected US growth. For 2024 we expect growth to be even weaker (2.6%), particularly in the AEs, before a recovery in 2025 assisted by some of the tightening in monetary policy that has occurred being unwound. These growth rates, if realised, are low by historical standards (with an average annual growth rate of 3.4% seen since 1980).

As we have noted in recent updates, risks around the outlook have become increasingly balanced. The progress made in reducing inflation, even as growth has held up better than expected, highlights the possible upside. A question remains at what level inflation settles; if it is above central bank targets then they could react by starting another round of rate increases. For now, many central banks seem willing to pause and see how the data unfolds, so this is more a risk to next year (and beyond). In the short-term energy prices have started to move back up; if this continues this might impact central bank patience. There are still various geopolitical risks, including the Ukraine/Russia conflict, and tensions between China and the US.

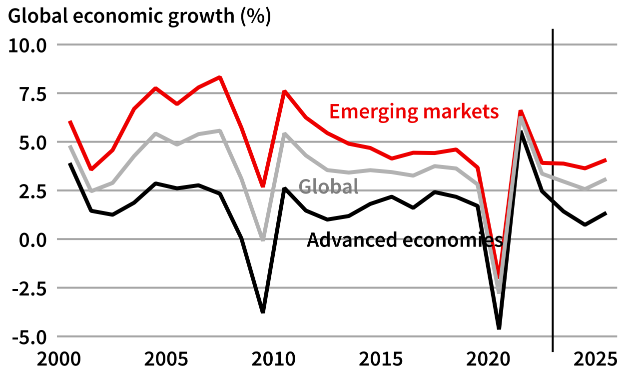
Global business surveys down over recent months



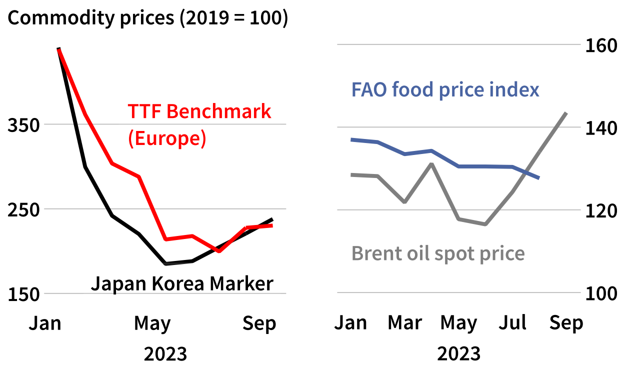
Tech cycle – some positive signs



2024 growth weakness expected to be most evident in AEs, with EMs more mixed



Risk from energy prices re-emerging



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