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The Forward View: Global October 2023

Inflation yet to be defeated – policy rates could stay high for longer

NAB Group Economics

Overview

- Global inflation again picked up in August, particularly in emerging market (EM) economies. A key contributor to recent inflation trends has been energy prices, including a lift in oil prices since June.

- Against a backdrop of still high inflation, and with activity and labour markets holding up better than expected, expectations around central bank policy rates have shifted. Rates are generally expected to stay at around current levels for longer in the major advanced economies (AEs). This has contributed to a tightening in financial conditions with equity markets weakening since mid-September, while bond yields have moved higher.

- Growth across the major AEs appears to have diverged significantly in Q3 2023, with it set to be strong in the US but weak (if not negative) elsewhere. The strength of the US economy has seen major advanced economy growth hold up so far this year. However, we expect it to ease from here, as the full impact of restrictive monetary policy settings comes through and given somewhat tighter fiscal policy settings.

- EM business surveys were somewhat softer in September, continuing the downwards trend in the EM composite PMI evident since May 2023. EM Industrial production growth has been relatively strong in recent months. However, with export volumes weakening, and with advanced economy growth likely to slow, it is hard to see this being sustained.

- Our forecasts for global growth in 2023 and 2024 are unchanged at 3.0% and 2.6% respectively, although our forecast for 2025 has been revised down slight to 3.0% (from 3.1% previously). Growth at these rates would be below the long-term average of 3.4% (recorded between 1980 and 2022).

- We still believe that the risks around our forecasts remain balanced, with the path of inflation (and implications for monetary policy) a key uncertainty. Recent developments in the Middle East highlight that geo-politics remains a key source of risk.

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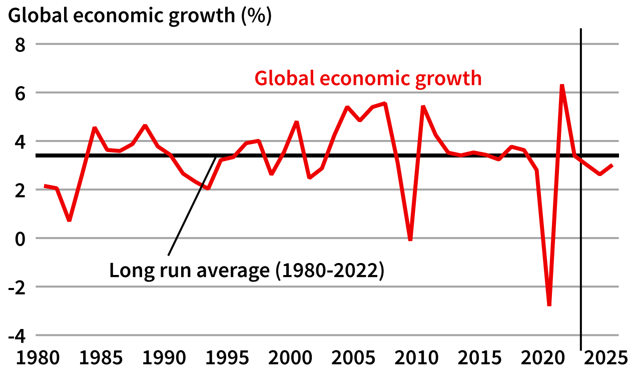
Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.2	5.8	1.9	2.3	1.2	1.2
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	4.3	0.6	0.5	0.6
Canada	-5.1	5.0	3.4	1.3	1.4	1.4
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	-7.0	7.4	4.1	2.1	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	1.2	0.8	3.1
Global	-2.8	6.3	3.4	3.0	2.6	3.0

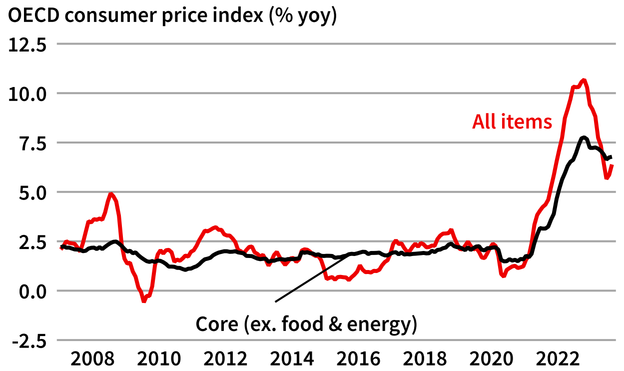
Sub-trend global growth for 2024 and 2025



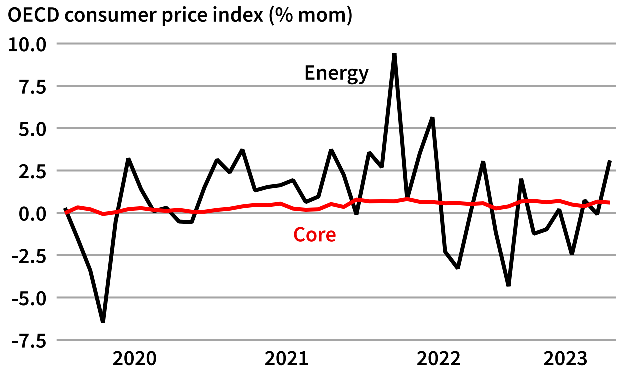
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: Global inflationary pressures remain a multi-faceted problem. Headline inflation in advanced economies moved higher in August, and while core inflation is still falling, it is doing so at a slow pace. US data highlights that both supply side (particularly driven by energy in recent times) and demand side pressures (which have been felt in the services sector) remain at comparatively high levels. The stickiness of inflation – particularly core services inflation - could force central banks to either hike further or persist at current rates for longer than previously anticipated.

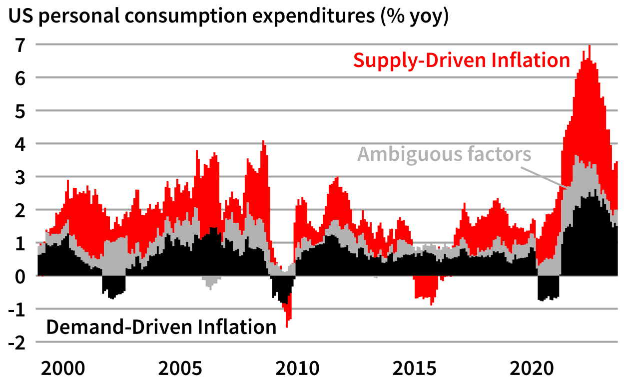
Headline consumer price growth accelerated for OECD economies in July and August. Core inflation continued to ease but remains at high levels.



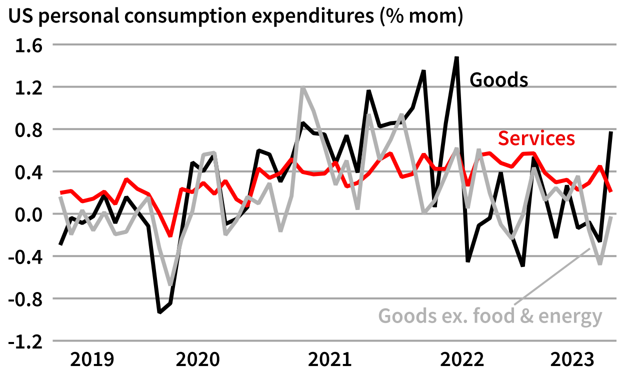
Weaker energy prices from H2 2022-H1 2023 helped drive down headline inflation, but this reversed more recently. Core inflation has persisted at relatively high levels.



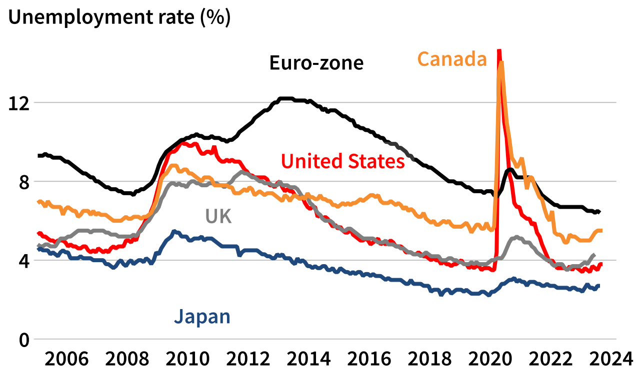
US data highlights that while supply side pressures have substantially eroded (but still high), demand pressure on prices has continued.



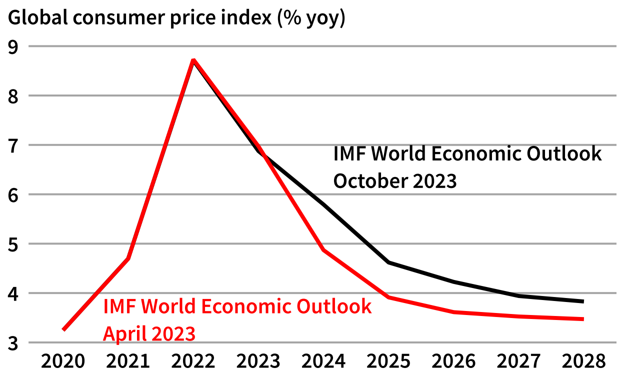
Between mid-2022 and mid-2023, service price inflation was the key driver of US inflation. Goods prices subsequently surged, but this was driven by energy.



Ongoing tightness in advanced economy labour markets – and associated pressure on wages – has supported the demand side (particularly for services)



The IMF's latest World Economic Outlook has pushed its outlook for global inflation high for longer – which may drive central bank strategy



Sources: OECD, Supply/demand decomposition of PCE inflation from Federal Reserve Bank of San Francisco, IMF, Macrobond, NAB Group Economics

Financial and commodity markets: sticky inflation raises chance of policy rates high for longer

Global inflation accelerated again in August, with consumer prices rising by 6.0% yoy (compared with 5.6% yoy in July and the recent cycle low of 5.3% yoy in June). As with the pickup recorded in July, emerging markets drove this increase, with Türkiye the main contributor (accounting for almost one-third of the increase in our EM measure) as prices surged almost 59% yoy in August.

That said, inflation also edged up in advanced economies, with our measure back to 4.5% yoy in August (from 4.4% yoy in July). This increase was driven by an acceleration in both the US and Canada, while inflation in the European Union continued to ease (having persisted at higher rates than North American economies).

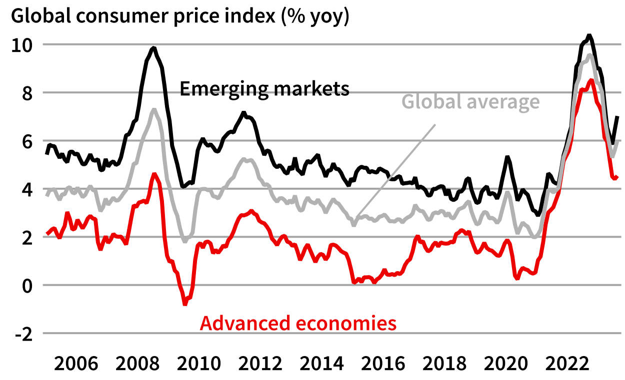
A key contributor to recent inflation trends has been energy prices. From recent lows below US$70 a barrel in late June, WTI crude oil prices moved above US$90 a barrel in late September (before a subsequent dip). In part this reflects production discipline from OPEC+ members, who have cut more than 5% of their output since October 2022. Any escalation in conflict in the Middle East, following the terror attacks in Israel in early October, could add further upward pressure to oil prices. In contrast, non-energy commodities (as measured by the S&P GSCI) have largely tracked sideways since mid-2022.

At this stage it is unclear whether the recent uptick in aggregate advanced economy inflation represents a short term pause in the path back to central bank targets or a fresh wave of price pressure. Central banks often focus on core inflation – removing volatile energy prices (among others) from the consumption basket – however core inflation has also been sticky and sustained high energy prices eventually flow through to other goods and services costs and can influence inflation expectations (and wage setting).

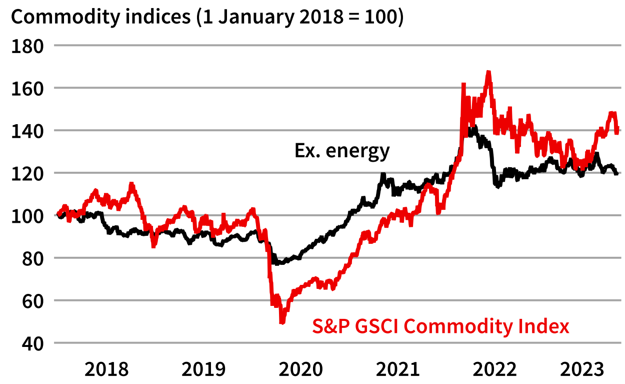
Given the volatility in inflation data, central banks frequently look through the cycle. With various moving average core inflation measures continuing to soften in advanced economies, this could keep banks on hold in the near term. Market pricing, at the time of writing, implies that the chance the US Federal Reserve increasing rates by December is under 50%. The market priced likelihood of a hike by the ECB is even lower. That said, there has been a notable shift in market pricing going forward – with rates remaining high for longer.

This shift in future rate expectations has contributed to a tightening in financial conditions (reducing any pressure central banks may have felt to lift rates further). MSCI equity market indices in both advanced economies and emerging markets have weakened significantly since mid-September. Similarly, bond yields – as indicated by 10-year government bonds for major economies – have trended higher in recent months.

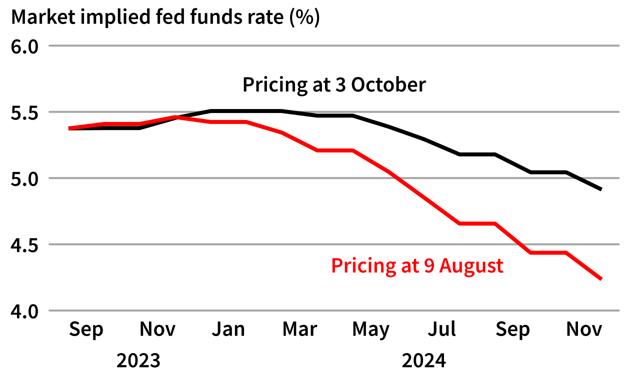
Global inflation accelerated in August, led by EMs



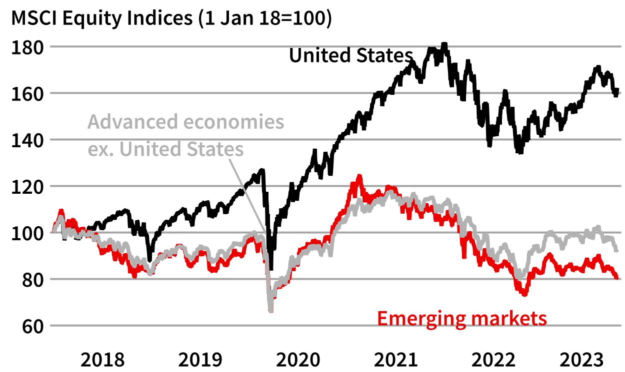
Energy has driven commodity indices higher



Policy rates could be high for longer



Equities contributing to tighter financial conditions



Advanced economies: Divergent growth in Q3 – US strong, weakness elsewhere

Growth across the major AEs appears to have diverged significantly in Q3 2023.

It looks to have been very strong in the US, supported by household consumption, inventory accumulation and, surprisingly against this backdrop, a likely net trade contribution due to weak goods imports. However, business surveys suggest the Q3 data are overstating the underlying strength in the economy.

In contrast, we now expect a small contraction in the Euro-zone in Q3. This risk has been flagged by the PMIs in recent months. Even with some improvement in Q3, this is still the case and partial data also point in this direction. Retail trade volumes have declined so far in Q3, as has manufacturing production, while the boost to service sector activity from COVID normalisation is fading. Similarly, UK monthly GDP data also point to a risk of negative GDP growth, although after a large fall in July, there was a modest rebound in August.

We also expect flat-to-negative Q3 growth for Japan. This is largely a correction to the strong growth reported in Q2 rather than a view that there has been a major weakening in the economy. Japan opened up later from COVID than the other major AEs and is likely still seeing a boost from a normalisation in activity even with household incomes being squeezed by the pick-up in inflation. Business surveys for Japan remain the strongest of the major AEs.

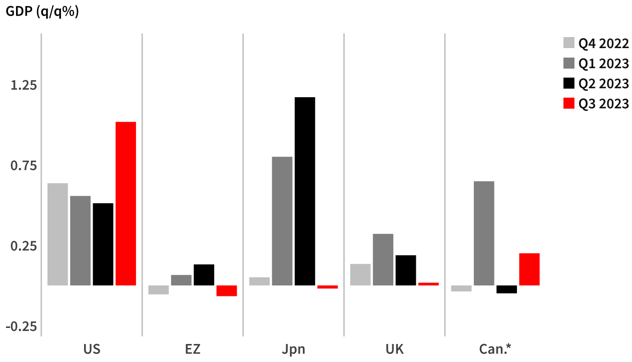
For Canada, the monthly GDP data points to GDP only edging up over July and August, suggesting some downside risk to our already modest forecast for Q3.

The strength of the US economy means that major AE growth has held up this year so far (averaging around 0.4% q/q to Q3), but we expect this to ease.

While we recently revised up our US forecasts out to Q2 2024 (but lowered the forecast beyond this), we still see a clear downshift in growth emerging, starting in Q4. In part, this reflects idiosyncratic factors – a likely smaller net trade/inventory contribution, a slowdown to the large increase in tech related construction and the resumption of student loan repayments. The latter is part of a broader turn in the US fiscal policy from tailwind to headwind.

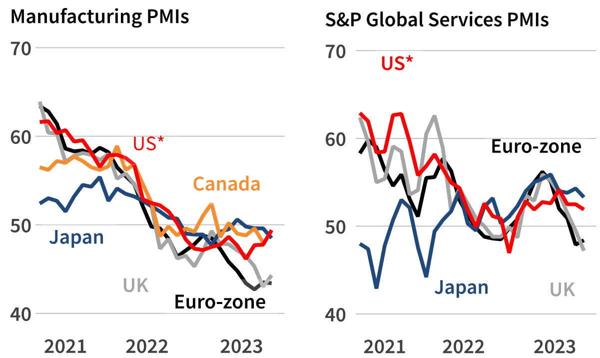
Moreover, we still expect that the restrictive monetary policy will impact growth, a point reinforced by the recent tightening in financial conditions and expectations that rates will be elevated for longer. This is also true for the other major AEs (ex Japan) while IMF estimates also point to some increase in fiscal headwinds in 2024 (including Japan). That said, Western Europe and Japan should gain from the large fall in energy prices (even with the recent upturn) over the last year.

Q3 GDP growth – likely weak outside US



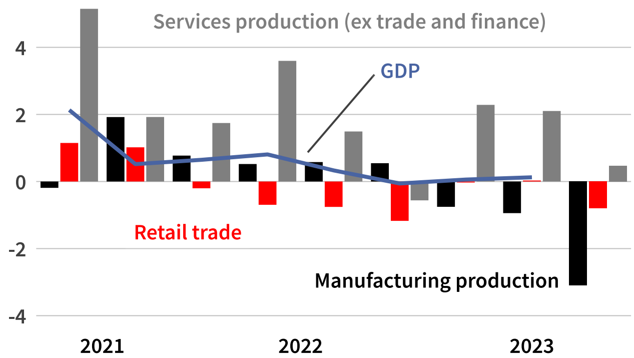
Source: Macrobond. Q3 2023 are NAB forecasts

Manufacturing weak but stabilising, services easing



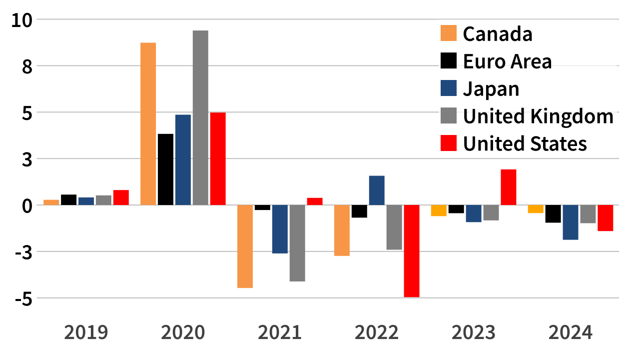
Partial data point to weak Q3 for Euro-zone

Euro-zone partial indicators and GDP growth (q/q%)



AE fiscal headwind in 2024 – led by US

Fiscal impulse - IMF estimates (% of GDP)



Sources: Macrobond, Refinitiv, NAB Group Economics. * US PMIs an average of the S&P Global and ISM indicators; for other countries S&P Global. Euro-zone partial data for Q3 2023 are based on data to August for IP and retail trade, and to July for services. Fiscal impulse measured as ppt change in cyclically adjusted budget balance as a % of GDP.

Emerging markets: slowing demand in advanced economies to weigh on EM industrial sector

Emerging market business surveys were somewhat softer in September – with the EM composite PMI down to 52.0 points (compared with 52.7 points in August). This measure has been trending down since May 2023.

A weaker trend in the services PMI has been the key driver over this period. In September, this measure dipped down to 51.9 points (from 53.1 points previously). China's services PMI was the main contributor – down from a relatively positive 51.8 points in August to an essentially neutral 50.2 points in September – along with weaker trends in Russia and Brazil (with the Brazilian measure turning negative). The services PMI measure for India remains extremely strong.

The easing in the EM manufacturing PMI was comparatively modest – down to 50.9 points (from 51.4 points in August). Softer readings in India, China and (to a lesser extent) Indonesia drove the decline, while Russia's manufacturing PMI was considerably stronger.

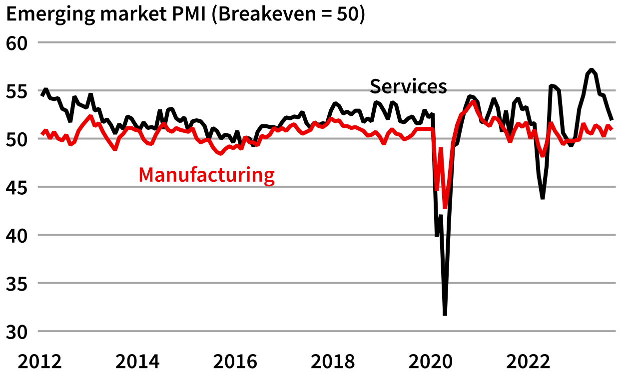
Despite a deteriorating global trade environment, industrial production in emerging markets has remained relatively strong in recent months. On a three-month moving average basis, EM industrial production rose by 3.0% yoy in July, stronger than the trend seen across the first four months of 2023, but weaker than that of the second half of 2022. Growth in Asia was comparatively strong – up by 4.2% yoy (3mma) in July – while growth outside Asia has been somewhat softer (up by just 1.0% yoy (3mma). Within this grouping, output in Latin America and Africa & the Middle East was notably weak.

The comparative strength of industrial production is somewhat at odds with the weaker trends in export volumes in recent months. These data have been highly volatile – with an unexpected spike in China's export volumes in March, before trending lower since April 2023, with aggregate EM export volumes contracting by 3.7% yoy in July.

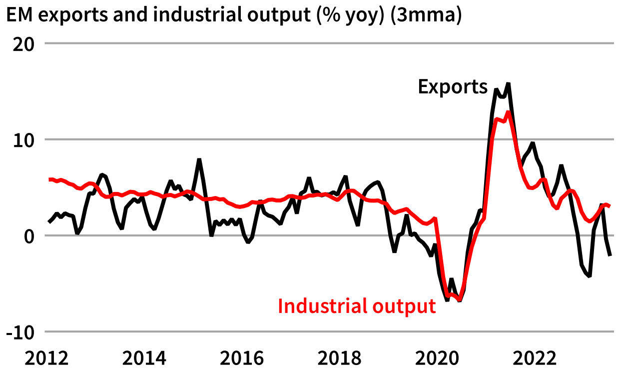
The majority of EM regions have seen export volumes falling in the past few months, with China and other emerging Asia being the key drivers of this trend. The only exception is Eastern Europe, where export volumes rose by 10.5% yoy in July, according to data compiled by the CPB. Trade within this region has been highly disrupted due to sanctions imposed on Russia following its invasion of Ukraine, but it is worth noting that the average price of exports from this region fell sharply – down by 33.5% yoy in July, meaning that discounting may explain some of the volume growth.

With the impact of tighter monetary policy slowing demand in advanced economies, combined with ongoing weakness in domestic consumption, it is hard to see industrial production in China – and by extension other Asia as well – persisting at current growth rates.

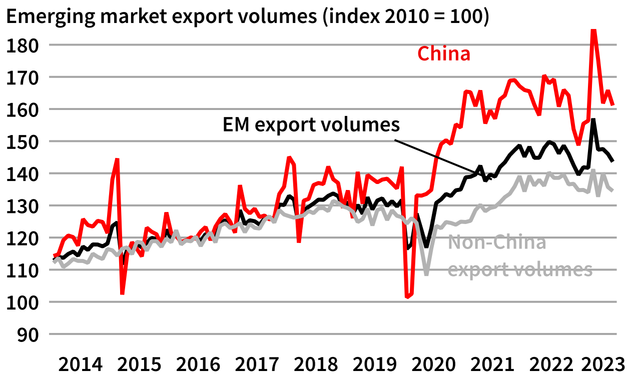
Services PMI weaker in September



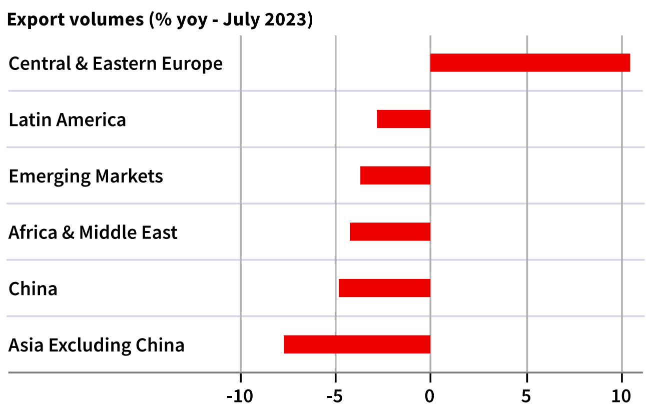
Industrial output holding up, even as exports fall



EM export volumes drifting lower



Eastern Europe an outlier in export activity



Sources: Macrobond, NAB Group Economics

Global forecasts and risks: global growth slowing into 2024

Compared with expectations at the start of the year, global economic growth has generally held up better than anticipated – with strength in advanced economies in the first half of the year more than offsetting the softening in China in Q2. That said, indicators are pointing to a slower trend more recently that is set to continue into 2024.

The JPMorgan global composite PMI edged down in September to 50.5 points (from 50.6 points in August) – the weakest reading since January 2023.

Since the recent cycle peak in May 2023, a deterioration in the global services PMI has been the main driver of the downturn in the composite measure. The services PMI dipped to 50.8 points in September (compared with 51.1 points previously), with emerging markets driving this trend.

In contrast, the global manufacturing PMI has been relatively stable in recent months – edging up to 49.1 points in September (from 49.0 points previously). EM manufacturing measures (on average) remain positive, albeit trending towards neutral levels, while the AE manufacturing PMI remains in negative territory. The continued softening in demand in advanced economies should impact EM manufacturing going forward.

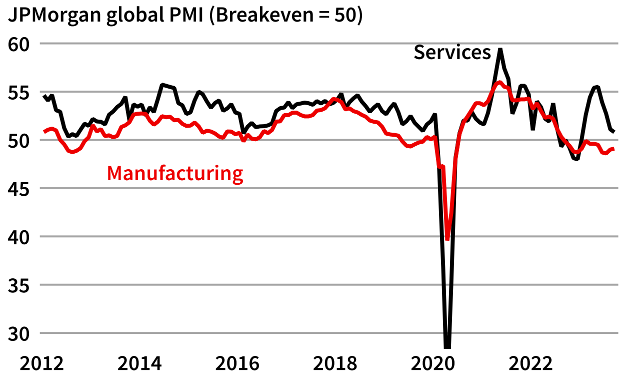
Our forecasts have not substantially changed this month. While the outlook for the US is marginally stronger for both 2023 and 2024, this was not enough to move our global forecast for either year – which remain at 3.0% and 2.6% respectively. A downward revision to US growth in 2025 (reflecting the slowdown being pushed out) is the key driver of a slight downward revision to our global forecast – to 3.0% (from 3.1% previously). Our overall outlook over this period is comparatively weak – below the long-term average of 3.4% (recorded between 1980 and 2022).

Key to this forecast profile is the path of inflation – as it gradually returns towards the targets set by major central banks – and by extension, the policy rate decisions of these banks. Although market pricing implies that most banks have completed their tightening cycle, it is clear that there remains a tightening bias and there is uncertainty around when the rate cutting cycle will commence – with the recent slowing of disinflation increasing the likelihood of rates remaining high for longer.

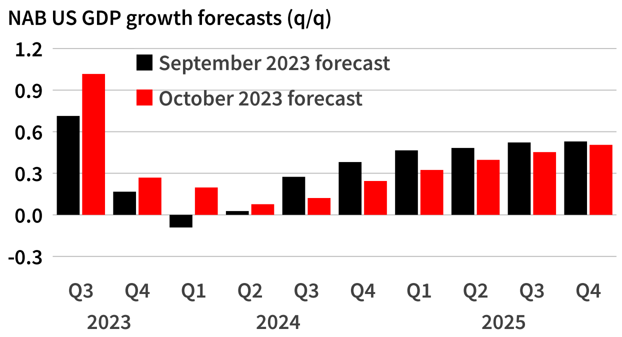
That said, we believe that the risks around our forecasts remain balanced, with the resilience in economic activity to-date, across many advanced economies, highlighting some upside to our outlook.

A range of geopolitical factors also present uncertainty to our outlook, including the Russia-Ukraine conflict, tensions between China and the US, further violence in the Middle East (which could further impact energy markets) and the US Presidential election in 2024.

Services guide composite PMI lower in September

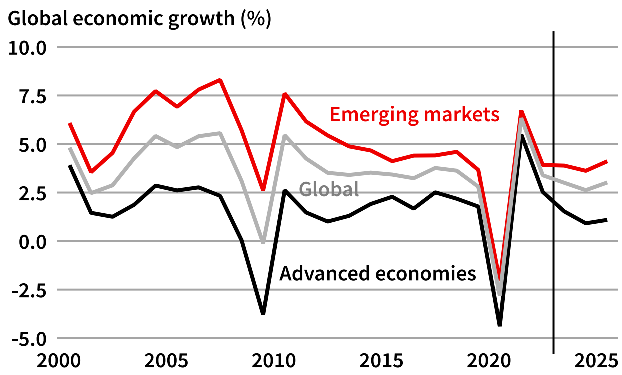


US growth profile pushed out means weaker 2025

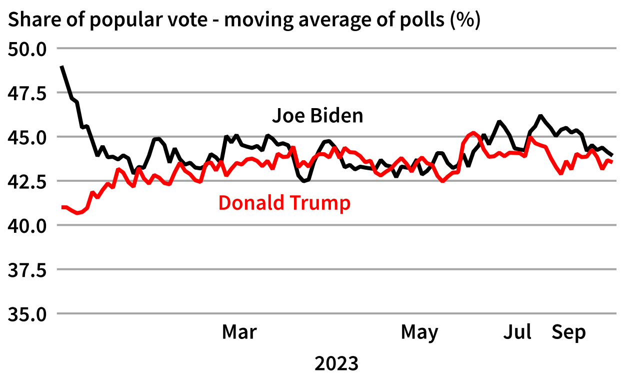


Source: NAB

AEs lead global growth lower in 2024 and 2025



Early US election polls shows a tight race



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

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

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