Embargoed until 11:30am AEDT 20 December 2023

The Forward View: Global Dec. 2023
Weaker inflation boosts rate cut hopes

NAB Group Economics

Overview

- For much of 2023, inflation in advanced economies has persisted well above central bank targets. Rapid inflation in services and tight labour markets led to further increases in policy rates along with expectations that these rates would remain at comparatively high levels for a prolonged period.

- However, the more recent retreat in inflation (down to 3.5% yoy for advanced economies in October) and commentary from central bankers has substantially shifted expectations. At the time of writing, five policy rate cuts by both the US Fed and European Central Bank were fully priced for 2024, with a high probability of a sixth.

- Revisions to major AE growth widened the gap between strength in the US and weakness in other economies. That said, the gap is not expected to continue, as the US slows from Q4 onwards.

- Growth in India and Russia was stronger than expected in Q3 – albeit there was some scepticism around both outcomes, given anomalies in India's disaggregated data and the propaganda value of Russia's outcome.

- Reflecting the stronger than anticipated growth in India, we have revised up our expectation for global economic growth to 3.1% in 2023 (from 3.0%). We continue to forecast a slowdown in 2024 to 2.7% (up from 2.6% previously). Outside the extreme outliers of the global financial crisis and the initial wave of COVID-19, this would be the weakest rate of growth since 2001. We expect a modest recovery to 3.0% in 2025, however our whole outlook sees growth below its long-term average of 3.4%.

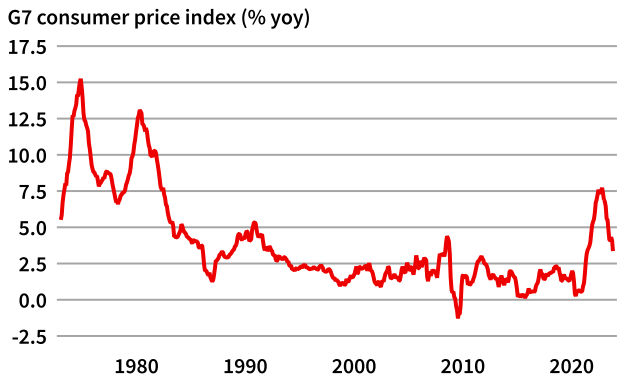
- The path of inflation remains the key uncertainty to our outlook – and with it the timing and scale of the eventual easing of monetary policy. Beyond this, geopolitical factors could continue to influence economic activity – including conflict in Russia-Ukraine and the Middle East, tensions between the US and China, and uncertainty around the outcome of the 2024 US Presidential Election.

Table of Contents

Global growth forecasts

	2020	2021	2022	2023	2024	2025
US	-2.2	5.8	1.9	2.5	1.4	1.2
Euro-zone	-6.2	5.9	3.4	0.5	0.4	1.1
Japan	-4.2	2.6	1.5	2.0	0.4	0.7
UK	-10.4	8.7	4.3	0.5	0.4	0.8
Canada	-5.0	5.3	3.8	1.1	1.0	1.3
China	2.2	8.1	3.0	5.2	4.5	4.8
India	-6.0	8.9	6.7	7.0	5.8	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	3.2	3.4	3.9
Australia	-2.1	5.6	3.8	2.0	1.4	2.0
NZ	-1.4	5.5	2.4	0.7	-0.1	2.7
Global	**-2.8**	**6.3**	**3.4**	**3.1**	**2.7**	**3.0**

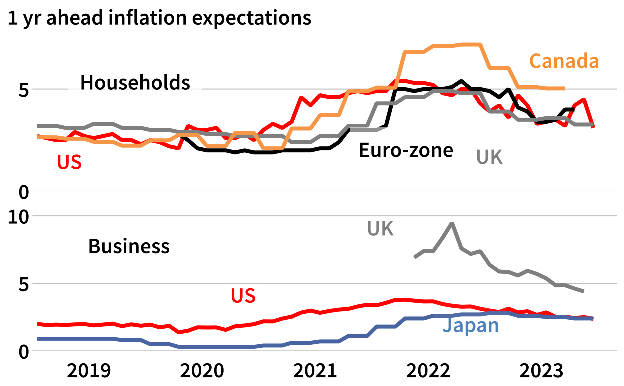
Advanced economy inflation slowing closer to target



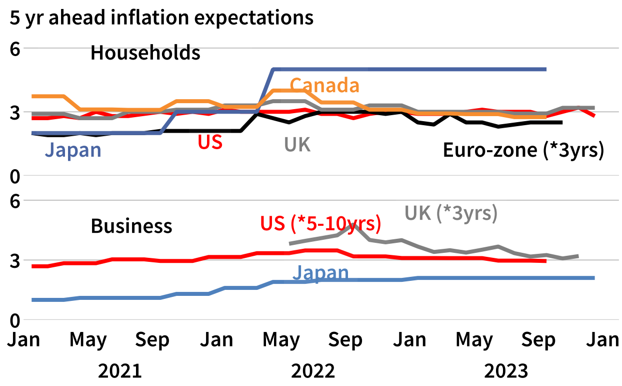
Gerard Burg, Senior Economist | Antony Kelly, Senior Economist | Alan Oster, Chief Economist

Charts of the month: In the major advanced economies, not only has inflation been falling but so have inflation expectations. This is important as (together with lower actual inflation and some easing in labour markets) it should help reduce wage growth pressure. It also means real interest rates are rising even as policy remains on hold, reducing the need for further hikes and, potentially, bringing forward cuts. Japan is the exception; the BoJ has not lifted its short-term policy rate and the lift in inflation (expectations) means real policy rates have actually declined. The lift in actual and expected inflation, however, indicates that the sustained lift in inflation that the BoJ has been seeking is close to being realised, and explains why, of the major central banks, market pricing only points to the BoJ lifting rates in 2024.

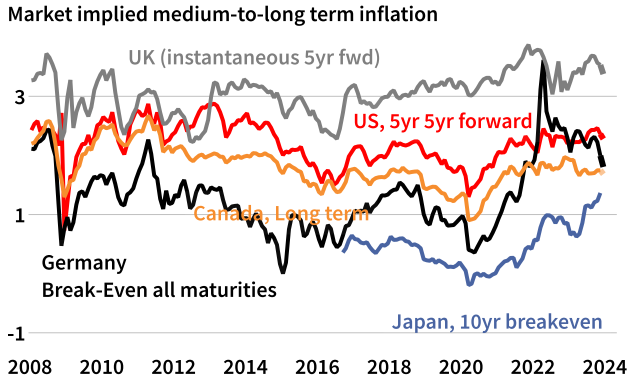
Short-term inflation expectations are falling except for Japanese households where they have stabilised



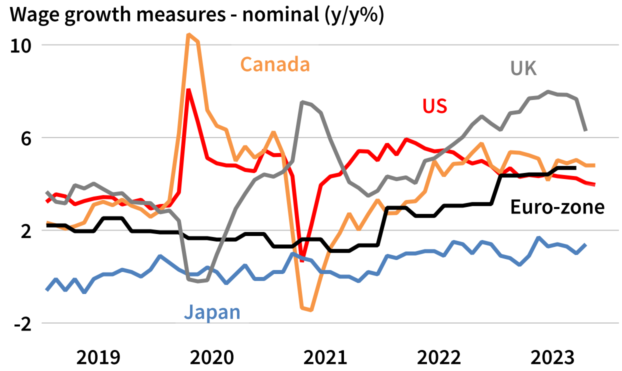
Medium term inflation expectations did not rise as much but have also generally moderated or stabilised. Japan has seen a material rise in expectations



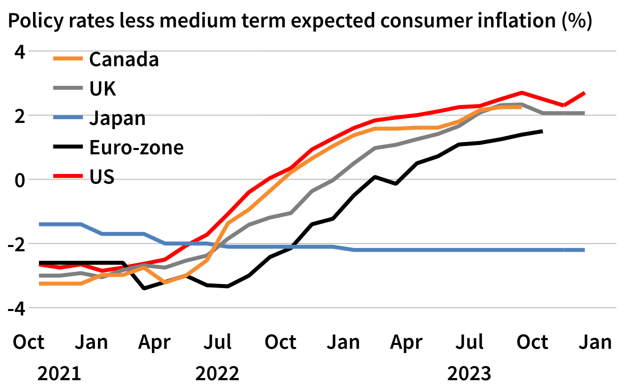
Market implied measures have also come-off their peak or remain well-anchored; again Japan the exception



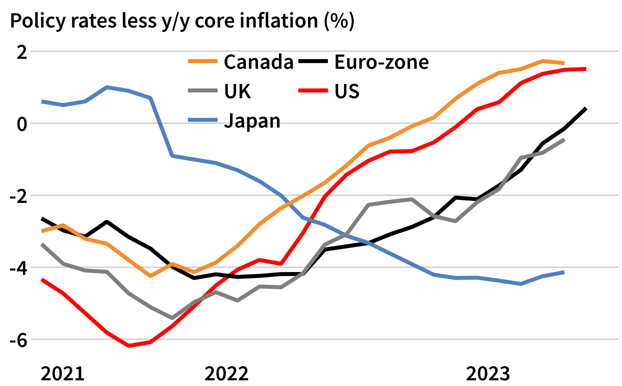
Central banks are focussed on wage growth due to impact on costs (and then prices). But causation runs both ways - the moderation in actual and expected inflation should add to downward wage pressure



Central banks have stopped raising rates but expected real rates still moving up – except Japan



Expected real rates have not moved up as much as real interest rates calculated using past inflation



Source: Macrobond

Financial and commodity markets: improved inflation trends boost hopes of monetary easing in '24

Global consumer price inflation continued to ease in October, with prices increasing by 5.3% yoy – its slowest rate of growth since November 2021. Inflation remains comparatively elevated in emerging markets – with prices up by 6.6% yoy (from 6.9% yoy in September) – albeit there is considerable divergence within this grouping – with extremely high rates in Türkiye, Egypt, Nigeria and Pakistan (largely reflecting idiosyncratic factors) contrasting with deflation in China and Thailand.

Inflation trends among the major advanced economies have been less divergent – with prices growing by 3.5% yoy in October (from 4.2% yoy previously), driven by a rapid easing in Europe.

For much of 2023, inflation in advanced economies (AEs) has persisted well above central bank targets. Rapid inflation in services and tight labour markets led to further increases in policy rates along with expectations that these rates would remain at comparatively high levels for a prolonged period. In mid-October, markets were pricing in relatively flat rate profiles for most major AE central banks. For example, a rate cut from the US Federal Reserve was not fully priced in until September 2024.

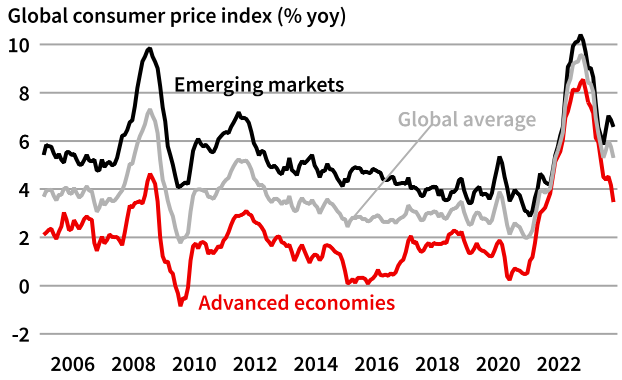
However, the more recent retreat in inflation and commentary from central bankers has substantially shifted expectations, notwithstanding some push back by the BoE and ECB at their most recent meetings. At the time of writing, five policy rate cuts by both the US Fed and European Central Bank (ECB) were fully priced for 2024, with a high probability of a sixth (which is more aggressive than our expectation of 100bp of easing by both the Fed and ECB over 2024).

As the shift in policy rate expectations gathered pace, so too did rallies in global equity markets. This was most evident in the United States – by mid-December, the S&P 500 had climbed by over 14% from its late October lows. Unlike the mid-2023 US market rally, this upturn was relatively broad based, rather than confined to the eight largest technology stocks (which tracked broadly sideways from mid-November onwards).

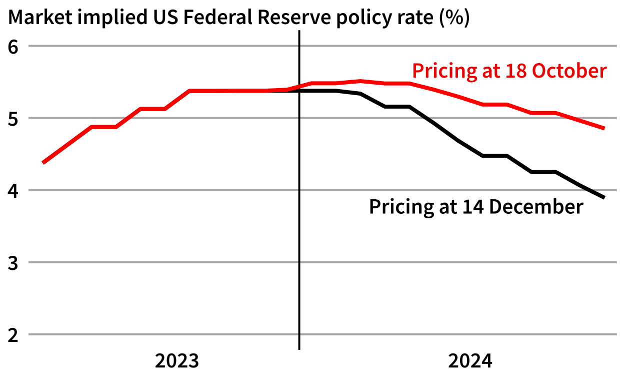
Similarly, there has been a rally in bond markets, with the yields on most AE 10-year government bonds trending sharply lower since mid-October. US Treasuries have seen the largest retreat in yields – down over 100 basis points (at the time of writing), while UK and German bonds have also substantially eased.

Commodity prices – as measured by the S&P GSCI – have continued to trend lower over the same period. The key driver of this downturn has been energy prices, particularly oil. Despite efforts by OPEC+ to constrain production, non-OPEC+ output has risen, particularly in the US, driving benchmark West Texas Intermediate (WTI) back below US$70 a barrel for the first time since June.

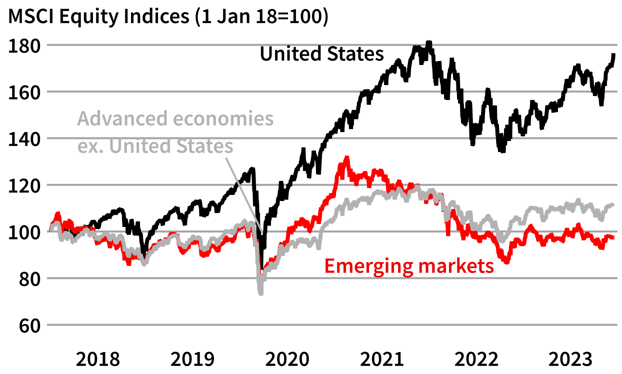
Advanced economy inflation continuing to trend down



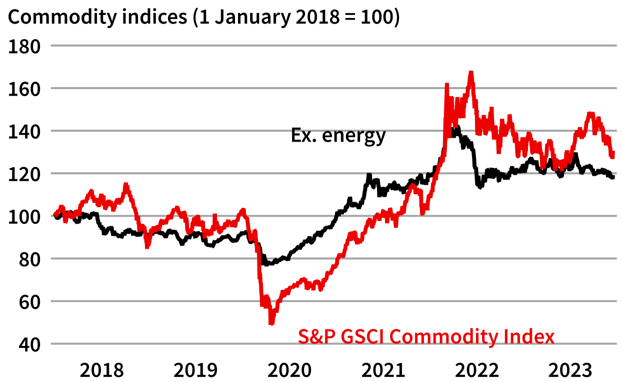
Market pricing of policy rates has shifted substantially



US led rally in global equity markets



Oil prices have retreated since late September



Advanced economies: Early indicators point to major AE growth slowing at end of 2023

Revised data suggest that the divergence in growth across the major advanced economies for Q3 was wider than previously thought. Previous estimates for Q3 GDP have been revised up in the US (from 4.9% q/q annualised growth to 5.2%) while Japan was revised down (to -0.7% q/q from -0.5%) and our expectation of modest growth in Canada was not realised as GDP declined 0.3% q/q.

The divergence looks set to narrow in Q4. Early data for the quarter suggests that US growth is set to slow, even though consumption remains solid and will get some support from the fall in gasoline prices.

At the same time, business surveys (PMIs) point to Euro-zone weakness continuing into Q4, and both retail sales and industrial production early in Q4 were tracking below their Q3 level. The PMIs for the UK have improved in recent months, but monthly GDP data declined 0.3% in October. There is a risk that both the Euro-zone and UK GDP will decline in Q4.

Stats Canada indications for October GDP were more promising (0.2% m/m), pointing to growth resuming in Q4. However, slower US growth, the decline in oil prices as well as the lagged impact of monetary tightening will constrain growth over the next year.

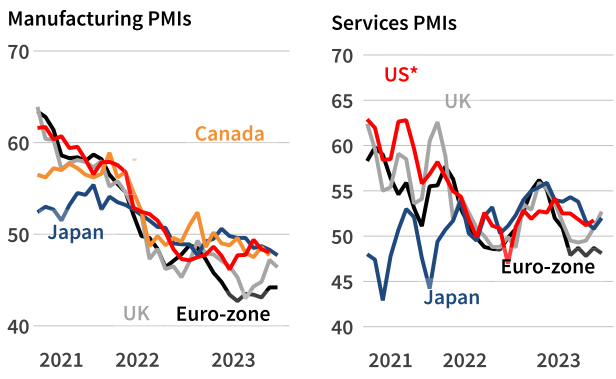
We also expect Japan to bounce back somewhat in Q4, with the fall in Q3 likely in part a correction to the strong Q2 outcome. However, domestic demand is weak, and the composite PMI has declined since August, so there appears to have been an underlying loss of momentum.

Overall, the PMIs have been pointing to a narrower growth differential across AEs than the GDP data. Manufacturing remains under pressure across the board, but there has been some improvement in the UK and, to a lesser extent, the Euro-zone, even as Canada and Japan heave eased. The service sector PMIs are performing better but are at generally subdued levels, particularly in the Euro-zone.

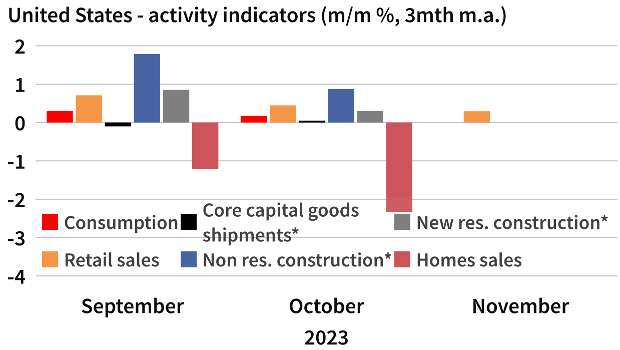
Labour markets remain tight, with unemployment rates remaining low by historical standards. However, they have started to edge up and other labour market indicators, such as job vacancies, are declining. For the US, the dichotomy between strong GDP growth and a (small) rise in the unemployment rate can be explained by a boost to labour supply from higher immigration and greater workforce participation.

We expect the slowdown in US growth will persist into 2024 due to the lagged impact of past monetary tightening and as fiscal policy tightens. These are also headwinds for the other major AEs (although monetary tightening in Japan has been minimal, and the recent UK Budget loosened fiscal policy settings). However, with inflation continuing to ease, we expect to see rate cuts in 2024 outside of Japan – which should support a recovery in growth, particularly in 2025.

PMIs still soft – particularly mfg and in the Euro-zone

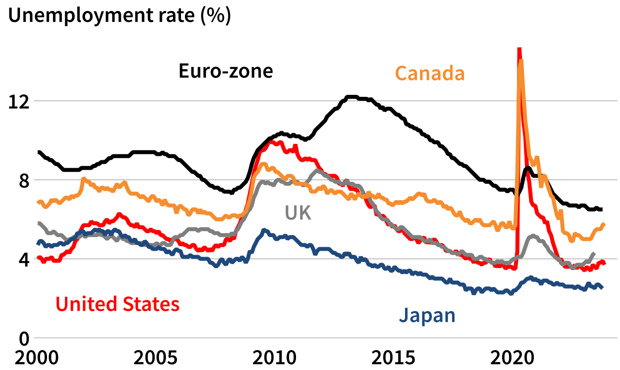


US growth set to moderate in Q4

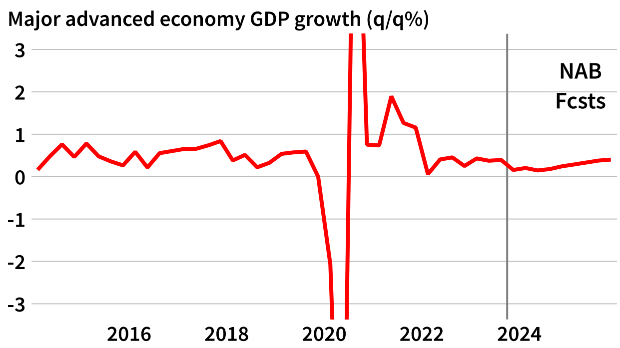


Source: Macrobond. * Deflated by NAB.

Labour markets still tight but gradually easing



Growth to slow in 2024 with a recovery over 2025



Note: axis cut-off for COVID extremes

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

Emerging markets: India and Russia record robust growth in Q3 but scepticism around the data

Emerging market business surveys were stronger on average in November, with the EM composite PMI pushing back up to 52.0 points – the same reading as September – up from 51.1 points in October.

The manufacturing sector was the key driver of this pickup, with the EM manufacturing PMI moving up to 50.9 points (from 50.1 points previously). China accounted for the bulk of this improvement – switching from a negative to a positive reading. It is worth noting that this measure – the private sector Caixin PMI – has been highly volatile in 2023 when compared with the official measure produced by China's National Bureau of Statistics – which remained negative in November.

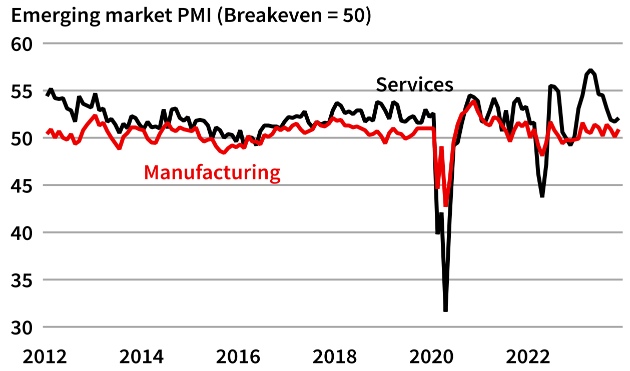
The EM services PMI edged up to 52.1 points, from 51.7 points in October. Once again, China was the main driver and there was also a sizeable inconsistency between private and official PMI surveys. In contrast, the Indian and Russian services PMIs were softer.

India's economy grew more strongly in Q3 than markets (and we) anticipated – increasing by 7.6% yoy (compared with 6.8% in the Reuters poll). Based on our seasonal adjustment of the data, India's quarterly growth accelerated in Q3 – up by 2.2% (from an already strong 1.9% qoq in Q2). That said, there were some anomalies in India's disaggregated GDP by expenditure data, with the major contributor to this growth in the past two quarters being its statistical discrepancy (which accounted for almost 60% of the year-on-year increase). Otherwise, there was strong growth in investment, up by 11.0% yoy, while private consumption growth was relatively muted, at 3.3% yoy.

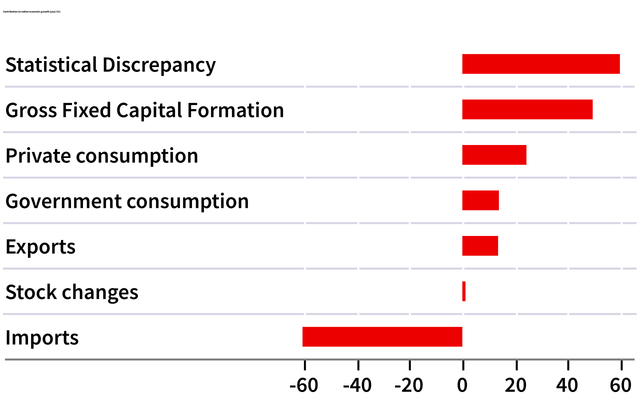
According to official data, Russia's economy grew by 4.2% yoy in Q3. There has been growing scepticism around the accuracy of Russian economic data following the war with Ukraine – with incentives to report stronger growth to imply that Western sanctions have been ineffective, while there is a reduced volume of other data available to independently verify official claims. As the third largest emerging market (albeit well behind China and India in terms of share of world GDP), distorted data has the potential to overstate global growth in the near-term.

Economic growth in emerging markets is generally more export dependent than is the case for advanced economies (AEs). Demand for goods is likely to continue to soften in 2024 – reflecting the lagged impact of tighter monetary policy and lending standards in major AEs – with import volumes in this region already down by 5.2% yoy in September. That said, export volumes from China and Eastern Europe ramped up strongly in year-on-year terms in September – up by 5.4% yoy and 18.4% yoy respectively. However, in the case of China, exporters have drastically cut prices, while trade in the latter has been disrupted by the Russia-Ukraine war.

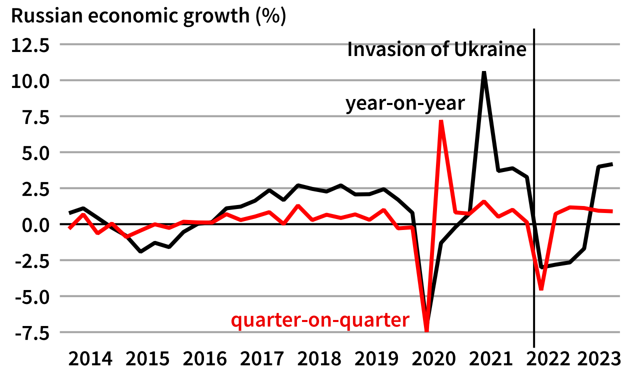
Stronger China surveys drove EM PMIs higher



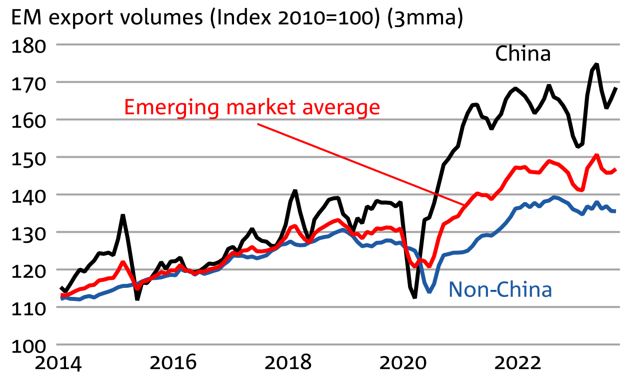
India's growth stronger than expected in Q3



Russian growth rebounding, but scepticism remains



China's exports have trended up in recent months



Global forecasts and risks: global growth set to slow from its relative strength in Q3

With more data becoming available, it appears that global growth accelerated (on a quarterly basis) in Q3 – up by around 0.9% qoq (from 0.6% qoq in Q2) – with China and India pushing up growth in the EMs, while resilience in the US offset weaker trends in other advanced economies, keeping AE growth steady. This growth rate could wind up stronger after Russian data is released, albeit we note the scepticism around its preliminary strength. Robust global growth is not expected to continue into Q4.

Global business surveys have softened considerably since mid-2023. While the JPMorgan global composite PMI edged back up into modestly positive territory in November – to 50.4 points (from a neutral 50.0 points in October) – these two months saw the weakest readings since January 2023.

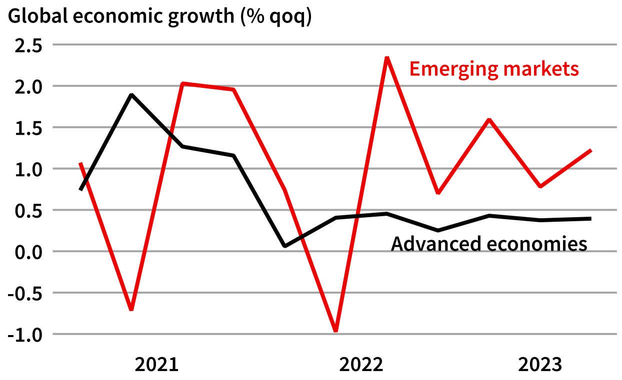
Key to the uptick in the composite PMI was global manufacturing, which moved up to 49.3 points (from 48.8 points in October). This increase was driven by a strong increase in the EM measure, with advanced economy manufacturing remaining in negative territory. In contrast, the moderate improvement in services was seen in both advanced economies and emerging markets.

Reflecting the stronger than anticipated growth in India, we have revised up our expectation for global economic growth to 3.1% in 2023 (from 3.0%). We continue to forecast a slowdown in 2024 – largely driven by the lagged effects of tighter monetary policy – with growth at 2.7% (up from 2.6% previously). Outside the extreme outliers of the global financial crisis and the initial wave of COVID-19, this would be the weakest rate of growth since 2001. We expect a modest recovery to 3.0% in 2025, however our whole outlook sees growth below its long-term average of 3.4% (between 1980 and 2022).

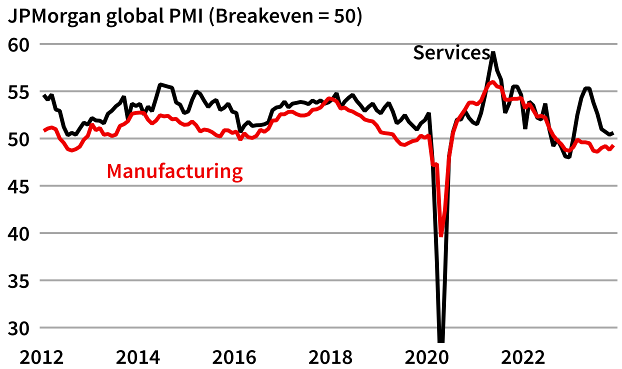
The recent slowdown in advanced economy inflation – faster than had been anticipated in recent months – highlights the ongoing uncertainty around its path going forward. Services inflation in advanced economies has remained comparatively high and has proved to be sticky. It will be necessary for these pressures to ease for inflation to return to central bank target ranges. That said, our forecasts assume that major AE central banks are already at the peak of their tightening cycle and will ease in 2024 (except Japan). The timing and scale of any easing in policy rates is also uncertain and could materially impact the pace of growth – most significantly in 2025.

Geopolitical factors may also influence the outlook for global growth. These include the Russia-Ukraine war and conflict in the Middle East – which could negatively impact energy and agricultural markets – as well as the tensions between the United States and China. The 2024 US Presidential election brings with it the potential for significant shifts in economic, trade and foreign policy, which could impact the broader global economy.

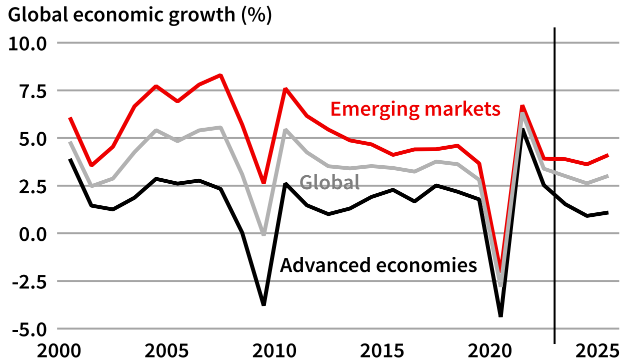
EMs drove acceleration in global growth in Q3



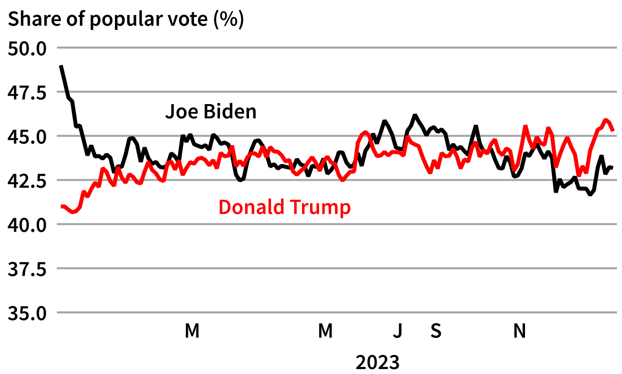
PMIs edged up in November, but trend is lower



Global economy set to slow, led by AEs



US Presidential election polling



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

Important notice