The Forward View: Global August 2024

NAB Group Economics

Overview

- Growth in the major advanced economies bounced back in Q2. GDP growth was stronger in Japan and the US, and broadly unchanged in Western Europe. We expect growth to be more moderate in the second half of this year even as labour markets continue to show signs of easing. Notably the US unemployment rate has risen in each of the last four months.

- Nevertheless, the better than expected Q2 GDP growth in Japan and the US, sees us lift our near term global growth forecasts while our expectation that the Fed will ease policy rates more quickly than previously considered (a change made earlier this month), sees an upwards revision further out. We still expect global growth to remain below its long-term average of 3.4% through to 2026.

- The rise in the US unemployment rate in July stoked fears that the US may be entering recession and, coupled with policy tightening by the Bank of Japan, lead to turbulence in financial markets in early August. This included large falls in equity prices, although markets have fully recovered since. While we see US growth slowing in H2 2024 we do not expect the economy to contract.

- The softer trend in emerging market business surveys continued in July, with the EM composite PMI in July recording its weakest reading since November 2023.

- Even though its domestic demand remains subdued, China's Third Plenum did not address this problem. Instead, it focussed on national security and industrial policy, including investment in "new productive forces" – sectors such as electric vehicles, batteries and renewable technologies. These industries were amongst those targeted for tariff increases in the United States and European Union in recent months. The surge in Chinese exports since mid-2023 has also seen countries in South-East Asia announce, or indicate that they are considering, trade restrictions on imports from China. As a result, trade risks remain elevated even ahead of the US Presidential election in November.

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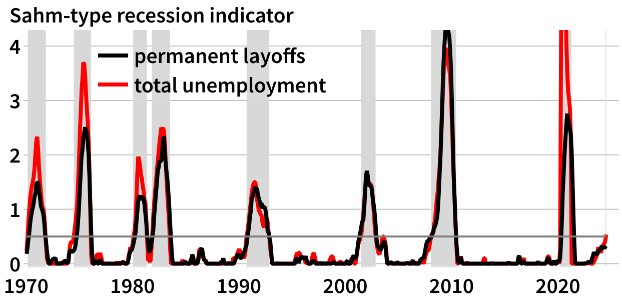
Global growth forecasts

	2022	2023	2024	2025	2026
US	1.9	2.5	2.5	1.5	2.2
Euro-zone	3.5	0.5	0.8	1.2	1.4
Japan	1.5	1.7	-0.1	1.0	0.7
UK	4.3	0.1	1.1	0.9	1.2
Canada	3.8	1.2	0.8	1.3	1.8
China	3.0	5.2	4.7	4.6	4.4
India	6.5	7.7	6.6	6.2	6.4
Latin America	4.2	2.2	1.3	2.2	2.2
Other East Asia	4.2	3.2	3.9	3.8	3.9
Australia	3.9	2.0	1.0	2.1	2.1
NZ	2.4	0.6	-0.2	2.1	3.0
Global	**3.5**	**3.2**	**3.1**	**3.1**	**3.2**

US Sahm rule triggered by July rise in unemployment – but this time less driven by lay-offs and we expect US economy to keep growing



3 month average of unemployment rate, or the rate of unemployment due to permanent layoff, relative to its trough of the trailing 12 months

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

Financial and commodity markets: fear of Fed mistake hit markets in early August

Global financial markets were hit in early August, as equity and commodity prices plunged along with bond yields. This appeared to be a response to a range of factors that coincided during this period – most notably US labour force data that showed comparatively weak jobs growth and a further (unexpected) rise in unemployment. The latter triggered the so-called Sahm Rule – where the three month average unemployment rate rises by more than 0.5 percentage points above its 12 month low – which has historically coincided with a recession, even though US economic activity indicators remain relatively solid.

The weak jobs data fuelled fears that the Federal Reserve had waited too long to commence its easing cycle – boosting market expectations of policy rate cuts in mid-August, with almost 100 basis points priced in through to December (compared with around 50 basis points in early July). Markets are also pricing larger than previously expected cuts (albeit less significant than for the fed funds rate) for both the European Central Bank and Bank of England.

Another factor impacting financial markets in August was the second rate hike this year by the Bank of Japan. This hit the Yen carry trade – where global investors borrowed in low cost Yen and invested in asset markets globally. Higher rates and a stronger Yen forced investors to rapidly reverse these positions – adding fuel to the selling pressure across a range of global assets.

Compared with the peaks of late July-early August, MSCI indices plunged between 6% (US markets) and 8% (emerging markets) by 5 August. US markets fell to their weakest levels since May, EM markets to the lowest since April while other AE markets to the lowest since February (before fully recovering by mid-August).

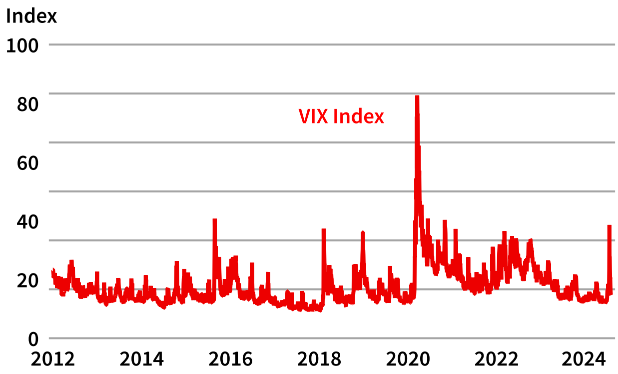
Within the US market, it is worth noting that steeper declines were recorded by the largest tech firms. This has raised speculation that the AI bubble may also have burst, with Nvidia (the dominant player in AI chips) down 27% in early August from its June peak, before rebounding.

Advanced economy inflation edged lower in June, down to 2.5% yoy (compared with 2.6% yoy in April and May and 2.7% yoy across Q1).

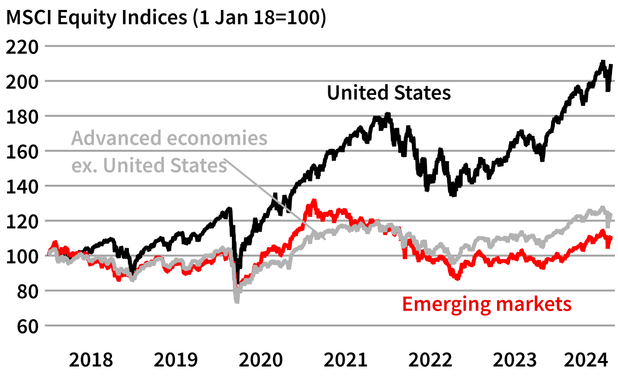
The shift in policy rate expectations and fresh recession fears saw bond yields plunge rapidly in early August. Compared with late July levels, 10 year government bond yields fell by 25 basis points in Germany, 30 bps in the UK and 48 bps in the US and have not subsequently rebounded.

Commodity prices, measured by the S&P GSCI, fell between early July and early August, driven in a large part by the unwinding of the speculative bubble in base metal markets. The index has since partially recovered from the trough, driven by an uptick in crude oil prices.

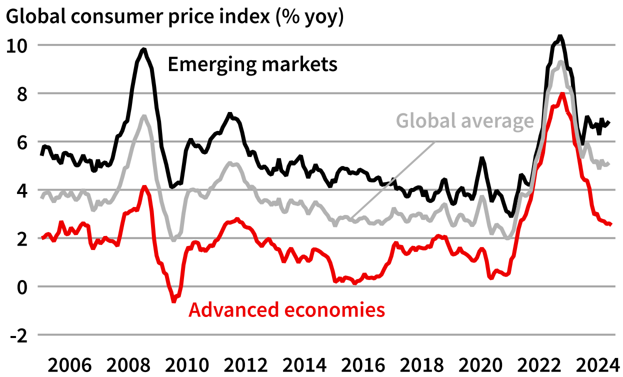
Market volatility rose in early August on various fears



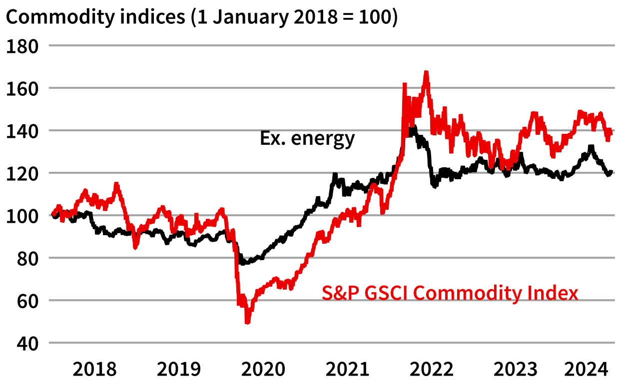
Fear drove steep correction in equity markets



AE inflation continues to edge lower



Speculative unwinding in metals but crude oil higher



Sources: Macrobond, NAB Group Economics

Advanced economies: strong Q2 as Japan and US bounce back, while Europe recovery continues

Growth in the major advanced economies bounced back in Q2, recording the fastest quarterly increase in over two years. GDP growth was stronger in Japan and the US, while it was broadly unchanged in Western Europe, and we expect this will also be the case for Canada.

While we had expected growth in the US and Japan to accelerate, the outcomes were stronger than our forecast, leading us to revise up our annual growth forecasts. Euro-zone and UK Q2 GDP growth was as we expected.

For the US, the Q1 and Q2 growth results indicate that growth, while still solid, has decelerated from its H2 2023 pace. While there are several positive growth drivers (such as tech related manufacturing investment and state & local government spending), business surveys readings are only modest and the labour market is weakening faster than expected. Consumption has been running above disposable income growth, and the slowdown in employment and wages growth will weigh on future spending, as will less support from wealth effects.

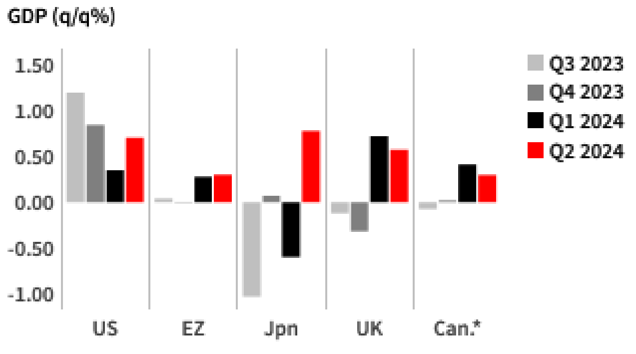
Outside the US, real household income growth has held steady or lifted this year, helped by real wage gains. Annual growth in regular scheduled pay in Japan is at its highest level in over two decades, and with inflation coming off its peak, it marks an end to the real wage declines that started in 2022. This, as well as tax cuts in June, likely supported consumption in Q2 in Japan. UK household consumption has also lifted but, but, in contrast, the flow through of improved household real incomes to Euro-zone consumption has been limited.

The PMIs for the Euro-zone also point to soft growth ahead, and downside risk to our Q3 GDP forecast, although we expect the lift in real incomes to eventually translate into stronger consumption, so we leave our forecast unchanged. For the UK, the monthly GDP data, and the PMIs, point to some loss of momentum as the year has progressed and we continue to expect some moderation in growth in H2 from its elevated H1 level.

Labour markets, while still generally healthy by past standards, are showing signs of easing. Recent financial market volatility was in part driven by softer US employment growth in July, and the fourth consecutive monthly increase in the unemployment rate. This, coupled with the reduction in inflation that has occurred, should see a further easing in wage growth.

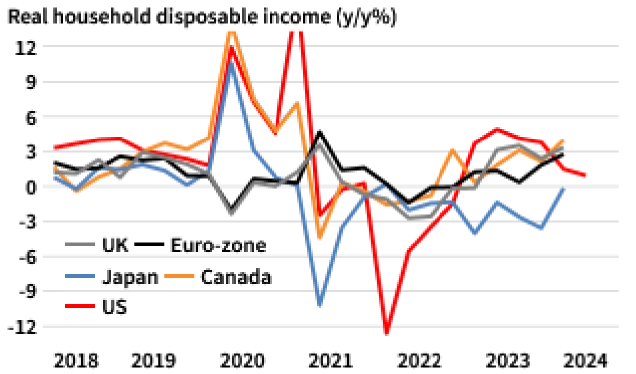
We expect AE growth to be modest in the second half of this year, but to strengthen over 2025 and 2026, as the impact of monetary policy easing flows through. Japan is an exception as monetary settings are being tightened. Fiscal policies are likely to remain a headwind, although in the case of the US, the outcome of the November's elections will potentially be important. The election may also influence other policies including for trade and migration.

US growth slower in H1 as other AEs improve

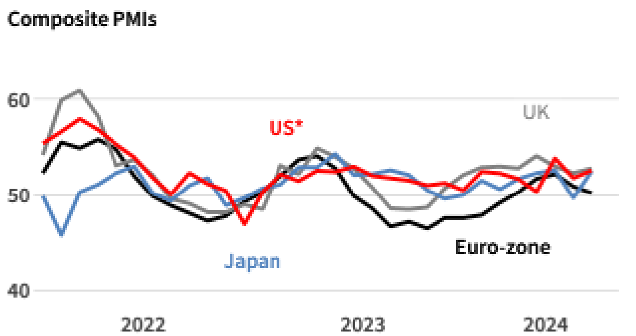


Source: Macrobond. Q4 2023 are NAB forecasts

Real h'hold income growth has picked up outside the US

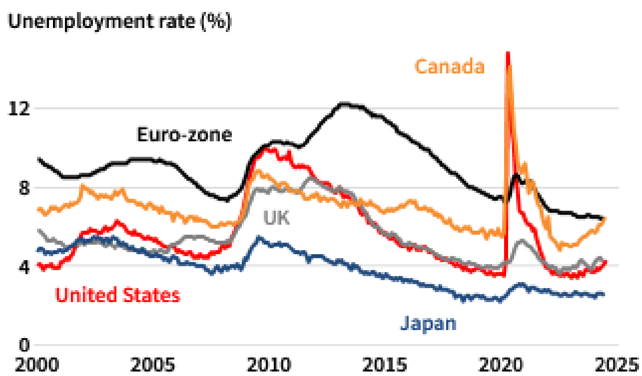


PMIs – Euro-zone has fallen back, modest elsewhere



* Based on S&P Global and NAB weighted composite of US ISM PMIs

Labour markets easing, including in the US despite strong growth



Emerging markets: China doubled down on supply side growth policies at Third Plenum

The softer trend in emerging market business surveys continued in July. The EM composite PMI eased to 52.4 points (from 53.3 points in June) – the weakest reading since November 2023.

Trends between the broad sectors differed last month, with the downturn driven by the manufacturing PMI, which dropped to 50.7 points (from 52.1 points in June). This fall was essentially driven by China – where its manufacturing PMI dropped just below neutral levels – while an uptick in Brazil was offset by a decline in Russia.

In contrast, the EM services PMI moved up to 53.2 points in July (from 52.6 points previously). China and Russia were the key drivers of this pickup.

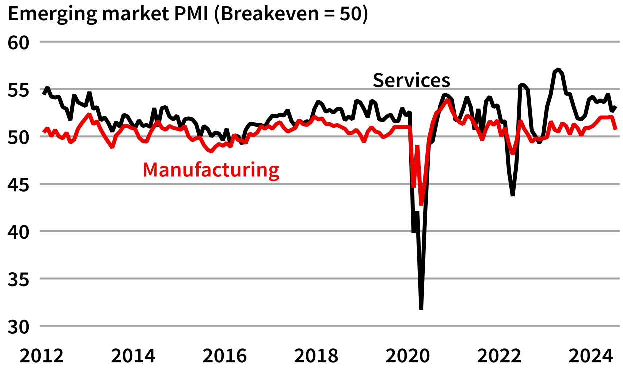
In mid-July, China's Third Plenum set the country's development agenda for coming years. Any hopes that China's government may seek reforms to support the demand side of the economy were disappointed, instead national security and industrial policy were the key focus – with the latter encouraging investment in "new productive forces" – including sectors such as electric vehicles, batteries and renewable technologies such as solar panels and other green energy. These include industries targeted for tariff increases in the United States and European Union in recent months based on accusations of overcapacity, unfair subsidies and the need to protect domestic manufacturers.

Domestic demand in China has remained relatively subdued following the COVID-19 pandemic – reflecting the downturn in the country's property sector and the lack of policy support for households. As a result, China's manufacturers have sought to expand exports in order to underpin production growth. According to China Customs data, the country's export volumes rose by 16.7% yoy in June, while the average unit price of these exports fell by 5.2% yoy.

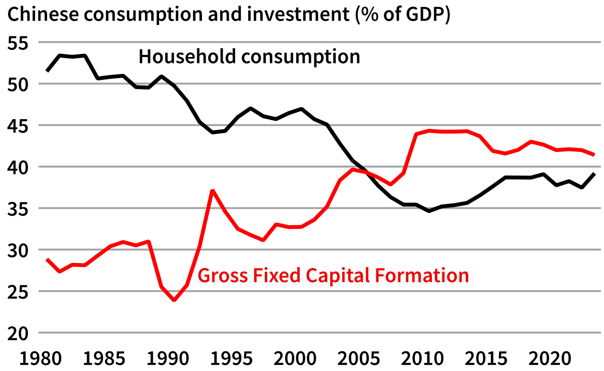
An August article in China Daily quoted three thinktank linked Chinese economists who urged authorities to implement either cash or voucher-based transfers to households to boost consumption. The article identifies the National Day holidays in October as a suitable time to implement the proposal, however given previous opposition to such policies by senior leadership, it is far from clear whether such a policy is likely to proceed.

Year-on-year economic growth in East Asia remained unchanged in Q2 – increasing by 4.2%. That said, growth slowed in quarterly terms, down to 0.8% qoq (from 1.2% qoq in Q1). Quarterly growth trends were highly divergent across the region, with South Korea's economy contracting in Q2 (following robust growth in Q1), steep slowing in Hong Kong and the Philippines, while Malaysia accelerated. Manufacturers are increasingly protesting the impact of low cost Chinese exports flooding the region.

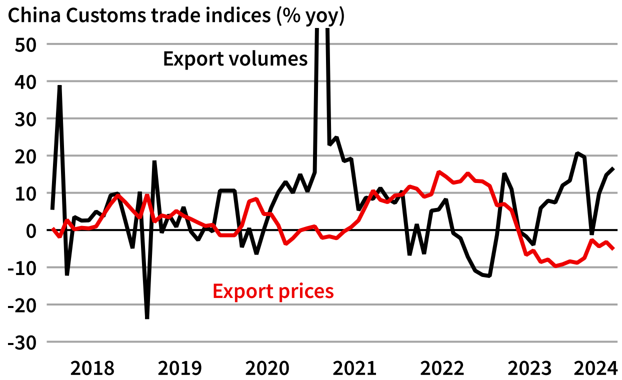
Manufacturing drove EM PMI lower in July



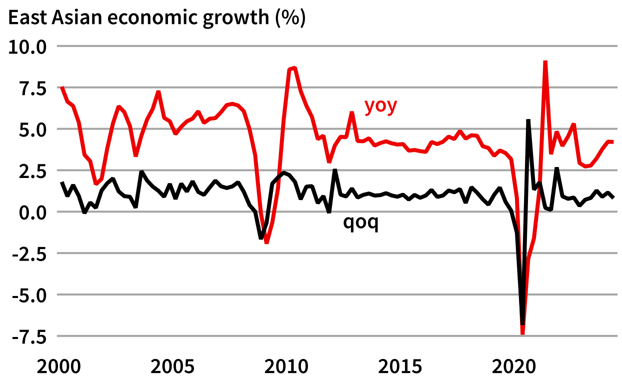
China policy yet to address weak consumption



China's export volumes continue to climb as prices fall



Mixed growth trends across East Asia in Q2



Sources: Macrobond, CPB, NAB Group Economics

Global forecasts and risks: modest upward revisions to forecasts, but growth to remain subtrend

Global business surveys softened further in July. The JPMorgan global composite PMI edged down to 52.5 points (from 52.9 points in June).

This decline was driven by the global manufacturing PMI, which fell into negative territory in July – down to 49.7 points, its weakest reading in 2024. The downturn in the EM PMI exceeded that of the AE measure.

In contrast, the global services PMI edged slightly higher – to 53.3 points (from 53.1 points in June). Once again, emerging markets were the main driver of this change.

This month we have revised our forecasts for the United States and Japan higher. These changes alter our aggregate global forecasts – meaning that we now expect the global economy to grow by 3.1% in both 2024 and 2025 (from 3.0% previously for both years), before moving up to 3.2% in 2025 (3.1% previously). We still see global growth remaining below its long term average of 3.4% (recorded between 1980 and 2023).

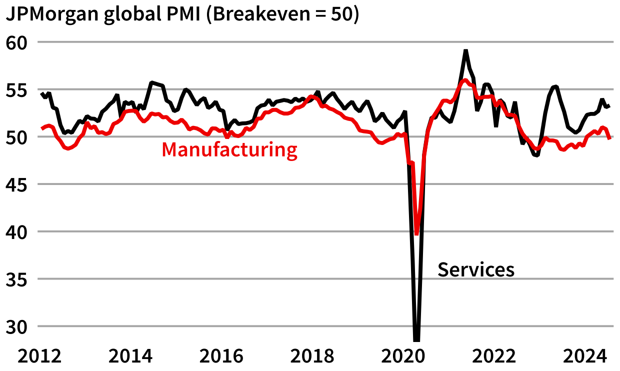
A broad range of factors present uncertainty around our outlook. Major advanced economy central banks have either started or are preparing to commence their rate cutting cycle, but the path back to neutral rates will depend on confidence with respect to inflation as well as the resilience of labour markets. Progress in reducing inflation in the major advanced economies has slowed in 2024, and has been uneven – where inflation will land remains uncertain. There is a long lag time between changes in monetary policy and its impact on the real economy, meaning that the timing and size of potential rate cuts in the near term could have a major impact on the outlook for 2026 (with less impact felt next year).

Trade policies – particularly with respect to China – also present some uncertainty. A range of countries have announced tariffs in response to the surge in Chinese exports since mid-2023, including the United States, the European Union and Indonesia. Other economies in South East Asia are considering measures – with smaller manufacturers in the region struggling to compete. For example, the Federation of Thai Industries reports an 86% yoy increase in the number of factory closures in the first half of 2024.

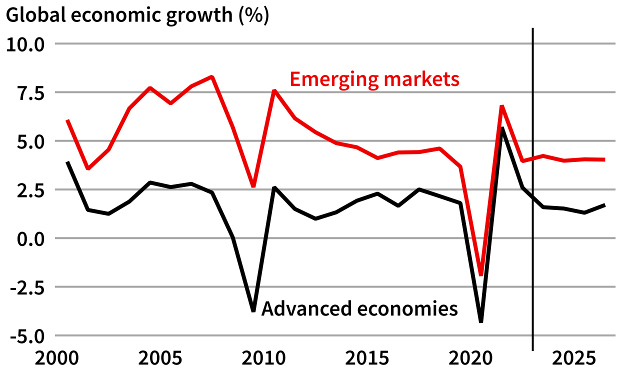
US foreign and trade policy could alter significantly depending on the outcome of November's Presidential election. Nationwide polling currently favours Democratic candidate Kamala Harris (following President Biden's withdrawal from the race), however the result will be determined by outcomes in key battleground states.

Geopolitical tensions persist, with various conflicts in Europe and the Middle East continuing, with the risk of further escalation that could disrupt trade and economic activity.

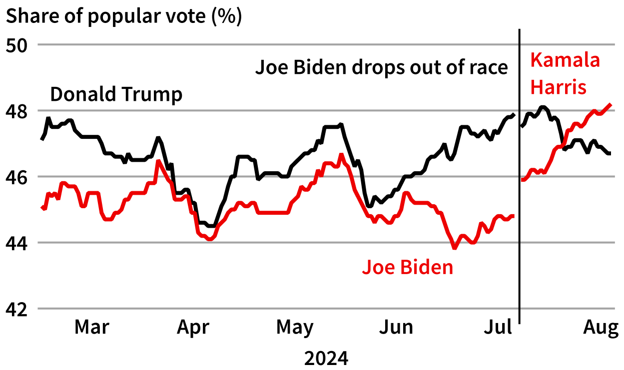
Global mfg PMI dropped into negative territory



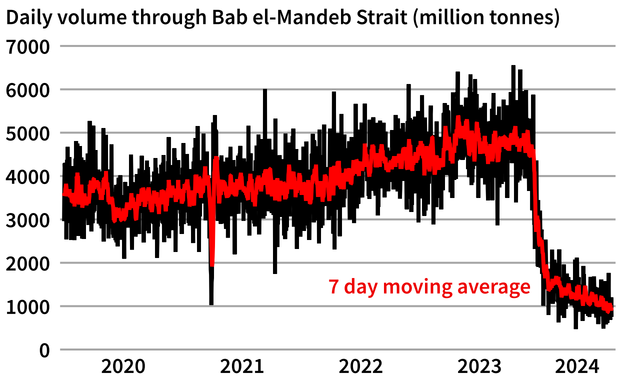
Softer AEs leads to subtrend global growth through '26



Change in candidate has altered US Presidential polling



Middle East conflict disrupting global trade activity



Sources: Macrobond, RealClearPolitics, IMF PortWatch, NAB Group Economics

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