The Forward View - Global February 2025

NAB Economics

Overview

Our estimates suggest that the global economy grew by a solid 0.9% q/q in 2024 Q4, similar to growth in Q3. While advanced economy (AE) growth eased in the quarter – as the US came off recent highs and Western Europe hit a soft patch – emerging market economies held up, including stronger growth in China.

Despite the improvement in the back half of the year, global growth, in year average terms, eased slightly in 2024 to 3.2% and is likely to slip further in 2025 and 2026. This reflects several factors, including an expected easing in US growth as it moves closer to its longer-term trend rate (in part due to a fading of recent supply-side and fiscal policy boosts) and ongoing structural issues in the Chinese economy.

While looser monetary policy settings will be supportive, fiscal settings are more mixed. Fiscal policy is contractionary in some regions, such as Western Europe (although political pressures are acting to reduce the magnitude) while China may continue to roll-out small-scale stimulus measures but potentially could do more if US tariffs have a major impact.

US fiscal policy direction is unclear – as the administration targets cost savings while Congress discusses tax cuts. Policy uncertainty is high in other areas, notably trade where US tariff policy is likely to be a headwind to global growth.

The US imposed additional tariffs on Chinese imports this month and announced tariffs on all steel & aluminium imports to take effect next month. Other tariff measures are almost certain to be announced but when they will take effect, and at what level, is unclear. Retaliatory measures by impacted countries are also likely, which could be met by escalation. The prospect of tariff increases may see some activity brought forward, but the uncertainty may see business investment deferred and consumers become more cautious.

Progress on reducing inflation led many AE central banks to cut rates last year, to make policy less restrictive. Further rate cuts are likely this year, with the pace likely to vary depending on how close inflation is to target, how far rates are from neutral and the strength of activity. The US Federal Reserve is likely to stay on hold for several meetings due to a strong economy and uncertainty around the inflation outlook. Japan is the main exception – it is gradually lifting rates from their current low levels as its long period of battling deflation appears over.

Geopolitical uncertainty remains elevated, although moves to negotiate an end to the Russia-Ukraine war, if successful, could boost global supplies of energy and agricultural products. Similarly, a sustained Middle East ceasefire could improve sentiment in a range of markets. However, positive outcomes in either region are far from guaranteed.

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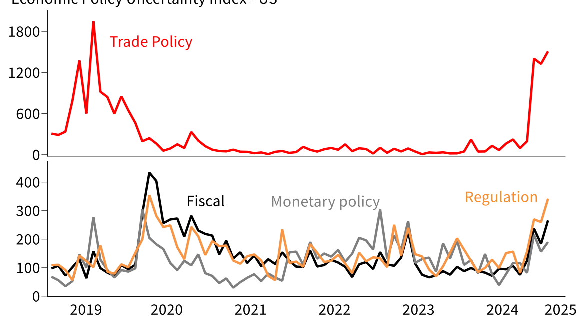
Key Economic Forecasts

	2023	2024	2025	2026
US	2.9	2.8	2.3	1.7
Euro-zone	0.5	0.7	0.9	1.2
Japan	1.5	0.1	1.3	0.6
UK	0.4	0.9	0.9	1.1
Canada	1.5	1.1	1.5	1.5
China	5.4	5.0	4.6	4.2
India	7.7	6.3	6.0	6.2
Latin America	2.2	1.8	2.3	1.9
Other East Asia	3.1	4.0	3.6	3.5
NZ	1.8	-0.6	0.7	3.1
Global	**3.3**	**3.2**	**3.1**	**3.0**

US policy uncertainty high & not just trade



Source: National Australia Bank, Economic Policy Uncertainty

19 February 2025 | Authors: Gerard Burg, Antony Kelly

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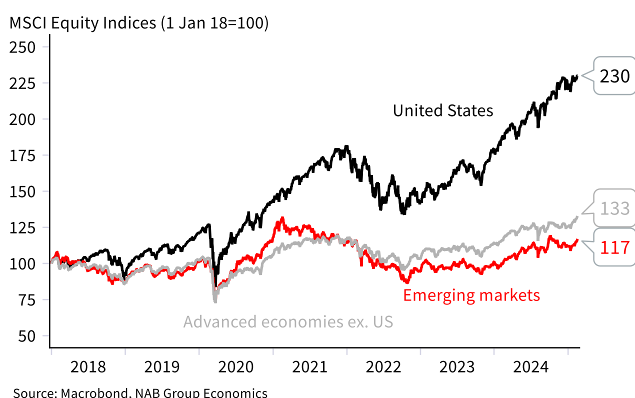
Financial markets

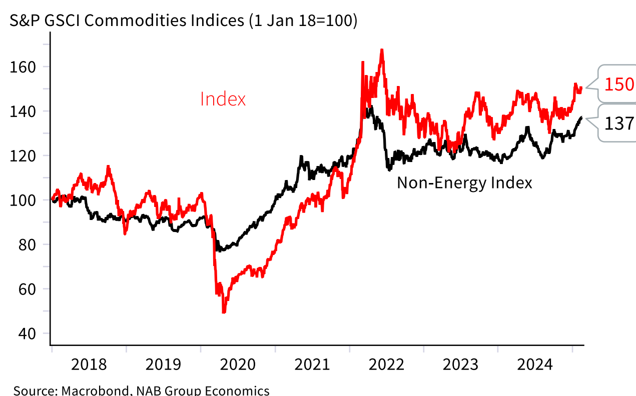
Trends in equity markets have been mixed since the US Presidential election in November. This reflects the uncertainty of the Trump Administration's agenda, with measures that could both positively and negatively impact US firms, and rapid policy shifts early into the new term regarding tariffs – including the sudden implementation and then pausing of tariffs on Canada and Mexico.

US markets reached a record high in early December and again in late January, before easing slightly and tracking sideways. Other advanced economy markets drifted lower from late September through mid-January, before rising to a record high in early February. A similar pattern was evident for emerging markets – albeit the upturn brought it back to the levels recorded at the start of 2022, and still well below its peak in early 2021.



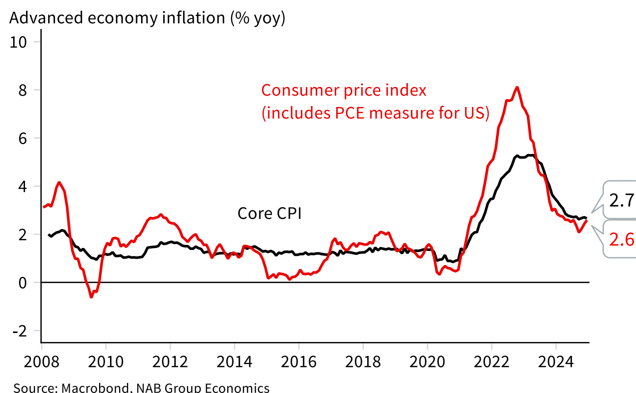
While many AE central banks have been easing monetary policy since mid-2024, yields on longer dated government bonds have generally remained elevated. This led to a more normal, upward sloping yield curve from late 2024 – with earlier economic jitters and expectations of policy rate cuts leading to an inverted curve (10 years vs. 2 years) for much of the period from 2023 through late 2024.

Commodity prices – as measured by the S&P GSCI – have trended higher since mid-December. Initially – between mid-December and mid-January – this was driven by an uptick in energy prices, which saw seasonal demand boost LNG prices while oil spiked in response to new sanctions on Iran and Russia by the outgoing Biden Administration. The subsequent trend has been driven by non-energy commodities – which rose to their highest levels since May 2022. In part this reflects gold prices, which set a new record high in early February (having risen strongly across 2024), while copper has also climbed as speculative positions increased.



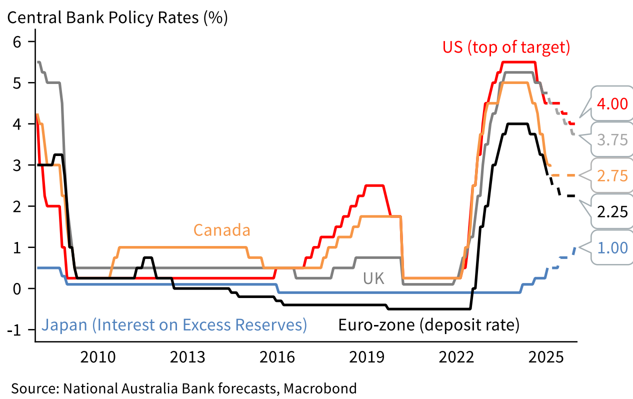
Inflation and monetary policy

Recent inflation trends in advanced economies (AEs) have been negative – with price growth accelerating since September (when it hit 2.1% yoy). AE headline inflation moved back up to 2.6% yoy in December – with the European Union and the United States the main contributors to this trend.



Most of the progress in lowering AE inflation from April through September 2024 was in volatile items – such as food and energy. Core CPI has broadly tracked sideways from April onwards and remained at 2.7% yoy in December. That said, there are important differences in core measures across regions. Both the Euro-zone and Canada are tracking around 2% (on a three-month on previous three months basis), while US inflation data remains above target and have been somewhat volatile – adding to the uncertainty about its future path.

Persistent above-target inflation, solid growth and receding labour market risks (and possibly also the prospect of additional price pressures from US tariffs) has reduced market expectations of policy rate cuts by the US Federal Reserve in 2025. In mid-February, markets were fully pricing less than 50 basis points of cuts, compared with an expectation of around 100bps as recently as October. We see the Fed remaining on hold across the first half of 2025, but making two 25bp cuts in the second half.



Source: National Australia Bank forecasts, Macrobond

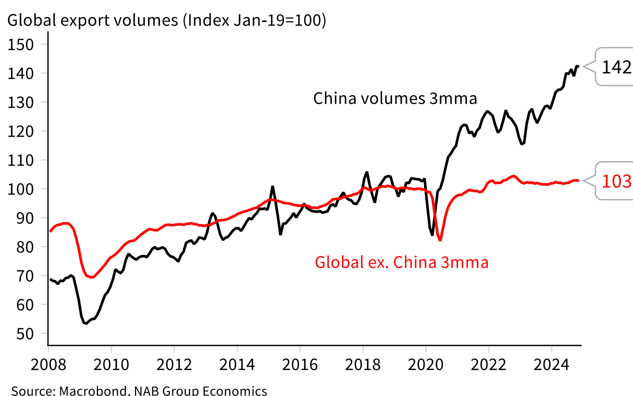
This is primarily a US phenomenon – market pricing for the ECB is broadly similar to that of late October, and only marginally higher for the Bank of England.

Concerns around the level of economic activity is also a factor for the European and Canadian central banks. The European Central Bank is expected to continue to reduce rates in coming meetings. The Bank of Canada has already significantly lowered rates and what happens with US tariffs will be important from here. The UK is caught in between weak growth and an expected lift in inflation this year, leaving the Bank of England to move cautiously. Japan is in a very different position with rates still very low and it is gradually tightening policy.

Global trade & tariffs

According to data by CPB, global trade volumes expanded by around 8.5% yoy in November, continuing the strong expansion that has been evident since the second half of 2020.

That said, this increase has been driven almost solely by China. Export volumes for the world excluding China are barely changed from the start of 2022 – only around 0.2% higher in November 2024 – while China's export volumes increased by 12.8% over this period.



Source: Macrobond, NAB Group Economics

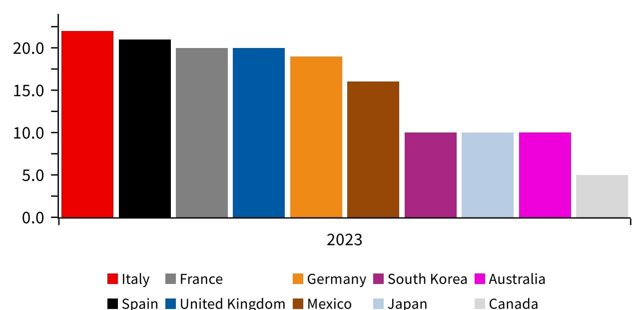
This reflects both the imbalances in China's economy – with domestic demand remaining weak in the post-pandemic period – and more recently efforts to front-run US tariffs.

Our expectation after the election was that US tariff rates would rise and we pencilled in a staggered 10ppt rise in the average tariff rate, starting around mid-year. Developments are clearly running ahead of this, but uncertainty around the ultimate level, and timing, of tariff increases remains extremely high. There is also the risk of retaliation to US tariffs setting off a round of tariff increases (as President Trump has indicated he will respond to retaliation) – similar to the US-China trade war that commenced in 2018, during the first Trump Administration.

The only increase in US tariffs so far is an additional 10% tariff on imports from China (from 4 February). Tariffs on all steel and aluminium imports (at 25%) are also scheduled to go into effect on 12 March. Before any substitution effects, these measures would represent an increase in the US average tariff rate of around 2ppts and an increase in taxes of 0.3% of GDP. China exports to the US are almost 3% of its GDP, and so, when scaled for the tariff rate, the burden on the China economy is similar (but trade diversion affects are likely to be relatively large). China also imposed some (limited) retaliatory measures on US imports. The major exporters of steel and aluminium to the US are Canada and Mexico.

This is just the early stages of what is likely to be an extended series of changes to existing trading arrangements. The next key dates will be early March and early April. 25% tariffs on US imports from Mexico and Canada were deferred until early March pending discussions between the governments. The first of April is the deadline for US officials to report to President Trump on a range of issues (covered in the America First Trade Policy Memorandum), with decisions on reciprocal tariffs also possibly as soon as this date. President Trump has also flagged that there will be an announcement on auto tariffs on 2 April.

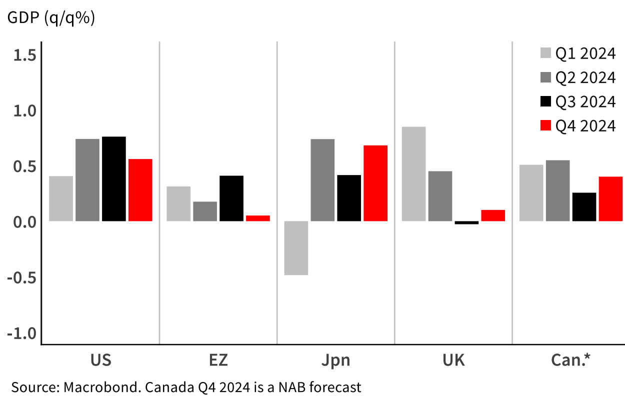
The application of reciprocal tariffs is potentially important as it is not limited to different tariff rates but also includes a consideration of non-tariff trade barriers, exchange rates, Value Added taxes (VAT) and taxation of US companies abroad. The major western European economies have VAT rates around 20%, while Mexico is not far behind with a 16% rate.



Source: National Australia Bank, OECD (Organisation for Economic Co-operation & Development), Macrobond

Advanced economies

Growth in the major advanced economies (AEs) eased in the final quarter of 2024. This was driven by a deceleration in US growth and the Euro-zone treading water (after a relatively strong Q3), while growth in the UK was modest. In contrast, Japan grew strongly in Q4 (0.7% q/q), but domestic final demand growth was more modest at 0.2%.

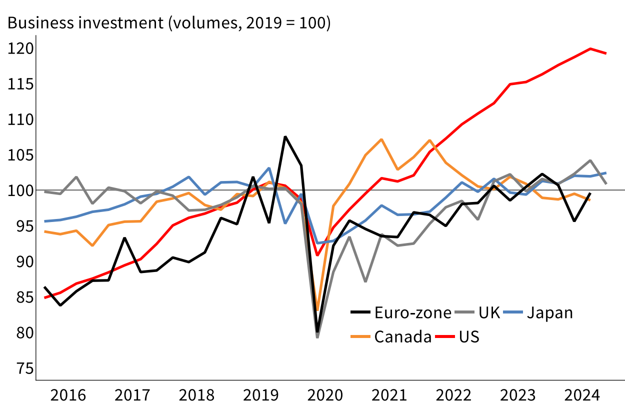


Source: Macrobond. Canada Q4 2024 is a NAB forecast

While US growth stepped down in Q4 to 0.6% q/q (from 0.8% in Q3), this still represents a solid outcome. A negative inventory contribution weighed on growth and domestic final demand continues to show strength (0.8%), with personal consumption growth the main driver.

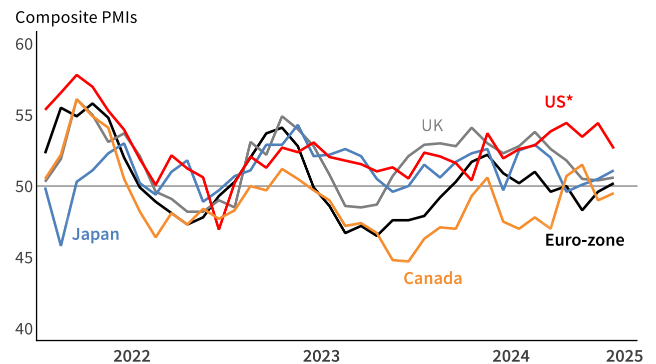
The expectation had been that growth in the AEs would continue to be supported by higher consumption growth. This was based around real household income gains from easing inflation, ongoing employment growth and wages still adjusting to past prices increases. This has played out to some extent but the lift in consumption has not been strong outside the US, as the flow through to consumption from higher incomes was muted by a lift in savings rates. In comparison the US household savings rate drifted down over 2024 and is low by historical standards.

US business fixed investment has also been stronger than in the other major AEs. Even with a slight fall in Q4, US business fixed investment is around 20% above its pre-pandemic level, whereas for the other major AEs it is little changed. Stronger general economic and profit growth may be a partial explanation (as business responded to growing demand), but with sector specific strength in high-tech manufacturing (driven by Government subsidies) and, more recently, data centres, an added factor.



One consequence of a lack of business investment outside of the US is that the long-running gap in productivity between the US and other major AEs is unlikely to narrow.

Euro-zone GDP was essentially flat in Q4 while UK GDP only edged up 0.1% q/q (and Q3 was revised down (to around zero from 0.2% q/q). This confirmed the signal from the PMIs which had hinted at only tepid growth for the quarter. However, there has been some improvement in the Euro-zone PMIs in recent months and for the UK, the monthly GDP data improved through the quarter, pointing to a better outcome in Q1. Coupled with the monetary policy easing underway we continue to expect that the Euro-zone and UK will experience modest growth this year.



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

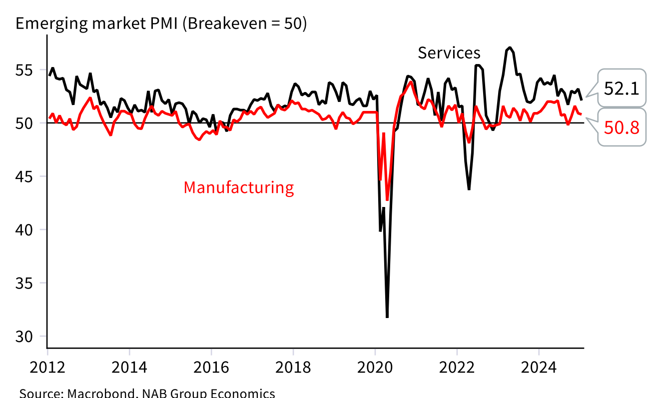
For the US we expect growth to moderate, but this is in part on the back of an easing in some supply side factors (e.g. declining migration) and waning policy boosts to demand (e.g. tech manufacturing). Tariffs – both actual impositions and the uncertainty they are causing – will also be a drag. Potentially there might be a short term lift in activity as businesses try to get ahead of tariff increases but uncertainty about future trading arrangements could see business investment deferred or cancelled.

The most exposed AE to US tariff policy is Canada, given its economy is highly entwined with the US. If the 25% tariffs currently on pause go into effect, they will likely have a material impact.

Emerging markets

Emerging market business surveys were somewhat weaker in January. The EM composite PMI moved down to 51.9 points (from 52.4 points in December 2024). This decline was primarily driven by the services sector.

The EM services PMI fell to 52.1 points (from 53.2 points previously). Service sector readings were considerably weaker for both China and India in January, while a stronger outcome for Russia was largely offset by a drop in Brazil – which moved into negative territory.



Source: Macrobond, NAB Group Economics

The manufacturing sector was only marginally softer, with the PMI down to 50.8 points (from 50.9 points in December 2024). Trends diverged among individual countries, with a

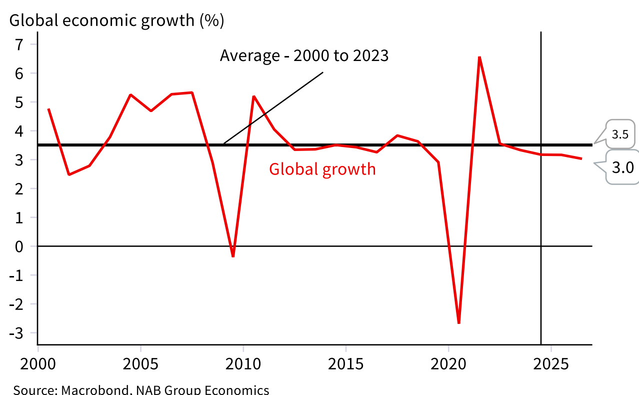
softer reading for China offset by slightly stronger readings for India and Russia.

While official data showed that China's economy grew in line with its target in 2024 (at 5%), there remain concerns around the imbalances between supply and demand. Monetary stimulus – implemented via both policy rate cuts and expanded liquidity in financial markets – proved largely ineffective due to weak loan demand, instead fuelling a bond market rally. Further fiscal expansion in 2025 has been mooted, however this could further exacerbate imbalances if it is directed towards the supply side of the economy rather than demand.

More urgent reform may be necessary if the Trump Administration follows through with the large-scale tariffs proposed during the election campaign – given that the US accounts for around 15% of China's exports.

Forecasts and risks

At a high level, our global economic forecasts are unchanged this month. We expect to see a modest slowing in growth across both 2025 and 2026 – to 3.1% and 3.0% respectively (compared with the 3.2% expansion estimated for 2024). This is below the trend rate of growth since the turn of the century (at 3.5%).



The key drivers of this expected easing in growth are the United States and China. In the case of the latter, we expect China to slow below 5% growth, reflecting the existing weakness in domestic demand, combined with the impact of growing trade restrictions – not limited to the United States – on its export sector.

It is worth noting that any forecast has a higher degree of uncertainty at the moment – largely related to the sizeable policy shifts in the United States that could disrupt trade and impact investment decisions in different regions. This is highlighted by threatened implementation of large-scale tariffs on countries such as Canada and Mexico that were subsequently suspended.

Various US policy shifts – most notably trade policy – could impact inflation in the near term. The extent to which the US Federal Reserve 'looks through' the inflation effects of higher tariffs is uncertain. How inflation expectations react will be important, as this will affect the Fed's assessment of whether the inflationary impact will be temporary or persist. Similarly, retaliatory tariffs in other countries could increase inflation globally. More generally, persistent above target inflation could slow anticipated cuts this year.

The US fiscal policy outlook – which will also influence Fed actions – is also uncertain. Our assumption is that fiscal policy will be broadly neutral but current efforts to cut spending while at the same time Congress is making moves to cut taxes points to risks either side of this assumption.

Geopolitical uncertainty remains elevated as well. Reports suggest that the US and Russia are attempting to negotiate an end to the Russia-Ukraine war – which in a best case scenario could boost global supplies of energy and agricultural products. Similarly, a sustained Middle East ceasefire could improve sentiment in a range of markets. However, positive outcomes in either region are far from guaranteed.

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

Gareth Spence
Head of Australian Economics
+(61 0) 422 081 046

Michelle Shi
Senior Economist
+(61 0) 426 858 831

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

Thao Nguyen
Economist – Data & Analytics
+(61 0) 451 203 008

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 Research
Corporate & Institutional Banking
+(61 2) 9295 1196

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