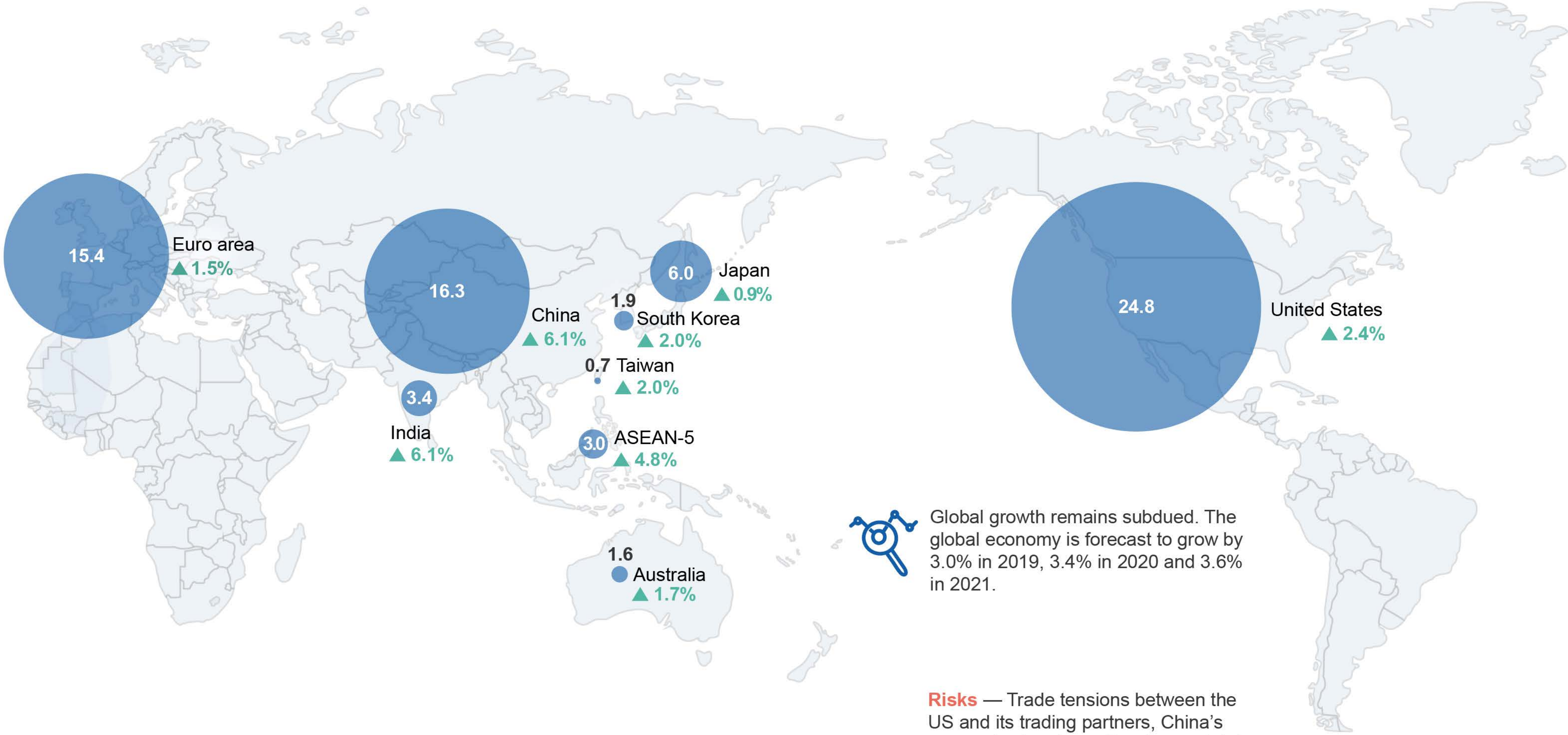
Macroeconomic Outlook

Resources and Energy Quarterly December 2019

= Share of global GDP

= Economic growth 2019*



Global growth remains subdued. The global economy is forecast to grow by 3.0% in 2019, 3.4% in 2020 and 3.6% in 2021.

Risks — Trade tensions between the US and its trading partners, China's economic slowdown, Brexit uncertainty.

*Source: IMF (2019) World Economic Outlook; Department of Industry, Innovation and Science (2019)

2.1 Summary

- In 2019, global industrial production and trade have weakened, largely due to US-China trade tensions, however, mid-December's Phase One US-China trade deal is expected to aid a recovery in 2020.
- Central banks are lowering interest rates to try to support growth.
- The IMF is expecting a pickup in global growth, with the global economy forecast to grow by 3.4 per cent in 2020 and 3.6 per cent in 2021 after growth of 3.0 per cent in 2019.

Global economy

World economic growth in 2019 has been revised downward by the IMF to an estimated 3.0 per cent — the lowest growth since 2008. Growth has been constrained by a slowdown in China, fallout from ongoing US-China trade tensions, and domestic economic issues in emerging nations such as Argentina, Iran and Turkey.

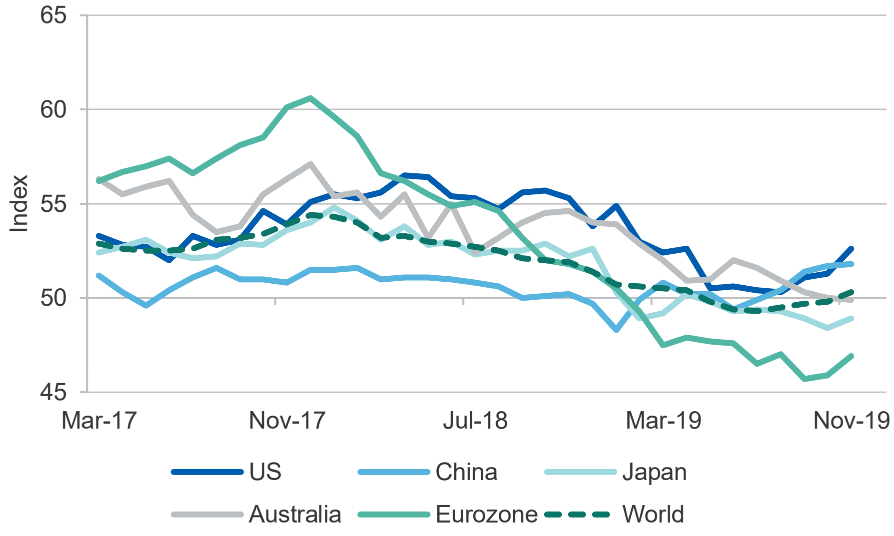
From mid-2019, global trade has fallen due to constrained industrial production and trade tensions. Tensions have also affected business investment decisions, materially affecting global supply chains. The outlook for world trade thus remains highly dependent on the outcomes of ongoing trade negotiations between the US and its major trading partners.

Manufacturing indices have fallen most strongly in the Eurozone (Figure 2.1). Key economies, such as Germany, have been impacted by the China slowdown, Brexit concerns, changing vehicle emission standards and global trade tensions. The Japanese Purchasing Managers Index (PMI) has also fallen, due to a drop in new orders from international customers.

The Manufacturing PMI's in China and the US have been relatively buoyant, despite ongoing trade tensions. Domestic consumption has generally outperformed global consumption in these two countries.

The global manufacturing PMI has fallen as a result of trade tensions and weaker global economic growth. The index fell to contractionary levels (below 50) in May 2019, and remained there until November 2019 when it rose to 50.3.

Figure 2.1: Manufacturing PMIs



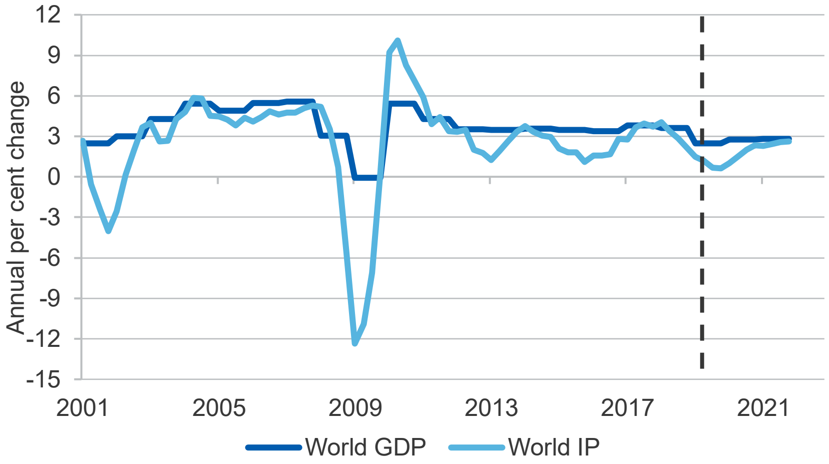
Source: IHS Markit (2019)

Business sentiment is particularly weak in the EU and Japan, though PMI values remain stronger in China and the US.

Some central banks are responding with more stimulatory monetary policy. This has occurred across advanced and developing economies, with significant impacts on global long-term bond yields. Some governments have also introduced fiscal stimulus packages. However, widespread adoption of fiscal policies has been constrained by high debt levels in certain countries.

As we publish, the United States and China have agreed to a Phase One trade deal. This deal should allow for a steady recovery in global industrial production growth in 2020 (Figure 2.2). Moves in world industrial production growth are strongly correlated with growth in world trade (Figure 2.3). A recovery in industrial production growth would be beneficial for resource and energy commodity demand.

Figure 2.2: Global GDP and industrial production growth



Source: Markit (2019), International Monetary Fund (2019), OCE (2019)

Figure 2.3: World trade vs world industrial production

Source: IMF (2019); Department of Industry, Innovation and Science (2019)

Geopolitical problems are also adding to risks to the world economic outlook. Tensions in Hong Kong, the Strait of Hormuz and Syria have proven to be particularly destabilising in recent quarters. However, diplomatic tensions between Japan and South Korea, and between India and Pakistan, may also influence global economic conditions.

In 2020, the IMF is forecasting that growth will rise to 3.4 per cent, due to a recovery in some developing economies currently affected by localised issues. Economic growth in Australia's major export markets is generally expected to remain around 2019 levels, although there is significant uncertainty arising from global trade tensions. World growth in 2021 is expected to increase further to 3.6 per cent, with higher growth in developing economies more than offsetting slightly lower growth in advanced economies. Growth is expected to recover to historical averages in South America, and the Middle East and Central Asia.

2.2 Country and regional economic conditions

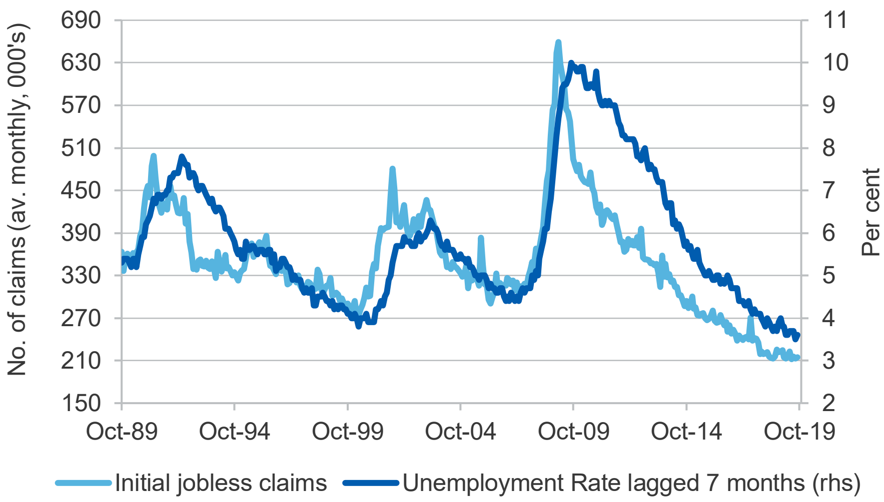
The US economy is expected to slow over the outlook period

The US economy grew by a forecast 2.4 per cent in 2019, supported by strong household consumption and employment (Figure 2.5). However, growth slowed throughout the year, falling to an annualised growth rate of 2.1 per cent in the September quarter, as trade tensions weighed on business investment.

In response to slowing economic growth, the US Federal Reserve cut the Federal Funds rate in August, September and October. Ongoing US trade tensions with multiple trading partners, including China, presents significant uncertainty to GDP and industrial production growth forecasts. These tensions have already constrained business investment, but consumer spending remains robust for now.

In 2020, the IMF is forecasting that economic growth will fall to 2.1 per cent due to dwindling impacts of the 2018 tax cuts and fewer assumed fiscal stimulus policies. Growth in 2021 is expected to moderate further to 1.7 per cent.

Figure 2.4: US unemployment rate and initial jobless claims, monthly



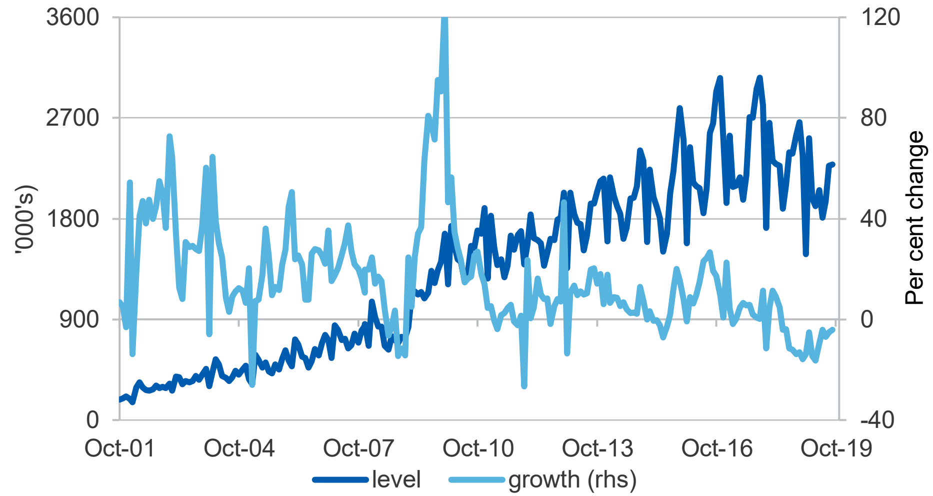
Source: US Bureau of Labor Statistics (2019)

Trade tensions weighing on the Chinese economy

China's National Bureau of Statistics estimated that GDP growth in the September quarter was 6.0 per cent — the lowest level since 1992. Growth has been negatively affected by US import tariffs on Chinese goods. The Chinese government has made a highly targeted series of economic stimulus measures in an attempt to achieve its growth target of 6.0-6.5 per cent. In November, the People's Bank of China eased monetary policy by lowering the 1-year and 5-year values for its benchmark rate. This is designed to lower borrowing costs as economic growth slows to 27-year lows.

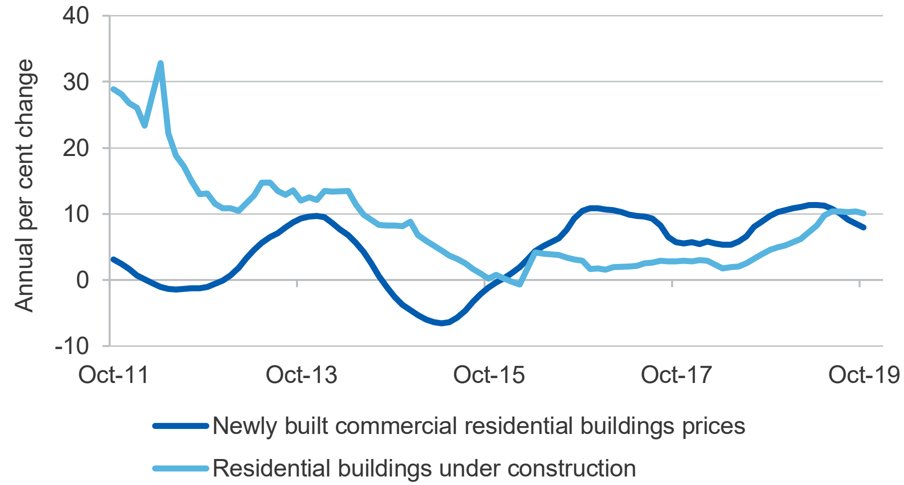
Chinese property markets are holding at relatively buoyant levels, after stimulus measures in some cities boosted activity in late 2018 and early 2019 (Figure 2.6). The Chinese PMI has risen since June 2019, reaching 51.8 in November. This was the third straight month above 50 reading, suggesting that the manufacturing sector is responding to strong ex-United States exports.

Figure 2.5: Chinese vehicle sales



Source: Bloomberg (2019)

Figure 2.6: Chinese property indicators



Source: Bloomberg (2019); National Bureau of Statistics of China (2019)

The Phase One US-China trade deal should help sentiment and, in turn, economic activity.

Chinese GDP growth is expected to fall to 5.8 per cent in 2020 before increasing marginally to 5.9 per cent in 2021.

Japan's GDP growth to slow

Japanese industrial production in 2019 has been affected by lower global growth and trade tensions. In the September 2019 quarter, the Tankan index for business confidence among big manufacturers fell to 6-year lows, and sentiment in other manufacturing sectors also weakened.

Machinery orders point to further declines in Japanese industrial production over the next few months (Figure 2.7).

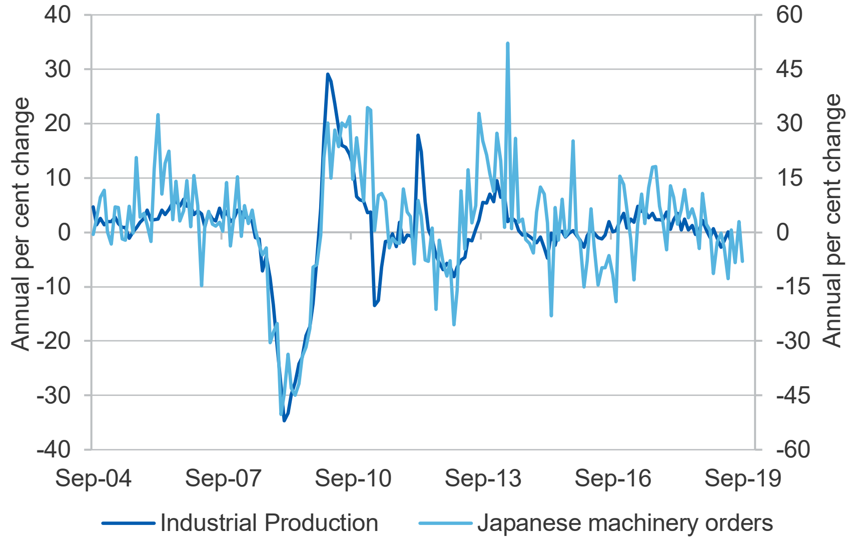
Recent Japanese trade agreements with the EU and the US are expected to deepen ties with these economies and support growth in Japanese incomes. However, there are downside risks if trade tensions between Japan and South Korea are not resolved when trade talks are concluded. These tensions began in July, when Japan placed trade restrictions on three chemical materials widely used by South Korean companies that make semiconductors. South Korea retaliated by removing Japan from the list of countries that receive stream-lined export protocols.

The October 2019 increase in the national sales tax in Japan is expected to place further downward pressure on GDP growth during 2020 and 2021, albeit with some offsetting impacts from the Olympic Games.

With the increase in the sales tax and trade tensions weighing on Japan's growth, the government announced a $US120 billion stimulus package in December 2019. This is expected to focus on repairing typhoon damage and maintaining infrastructure investment beyond the 2020 Olympics.

The IMF is forecasting Japanese GDP growth of 0.9 per cent in 2019. Growth is expected to fall to 0.5 per cent in 2020 and 2021 due to lower household consumption.

Figure 2.7: Japanese industrial production vs machinery orders



Source: Bloomberg (2019)

South Korean growth impacted by trade tensions

South Korean economic growth has remained weak throughout 2019, impacted by the economic slowdown in China and the US, and trade tensions with Japan.

Economic growth is projected by the IMF to be 2.0 per cent in 2019 and 2.2 per cent in 2020. Growth is forecast to recover to 2.7 per cent in 2021, as trade conditions are assumed to return to normal.

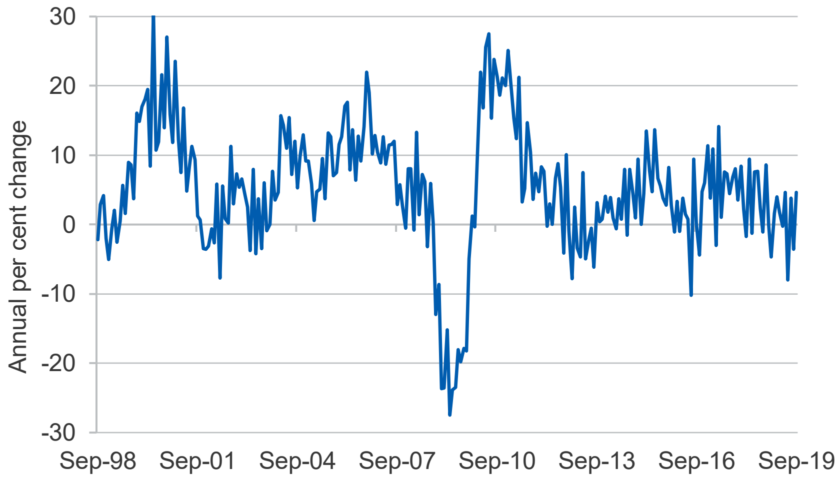
Europe faces sluggish growth and rising risks

Eurozone growth fell in 2019, particularly in Germany and Italy. The German manufacturing sector has been affected by Brexit uncertainty, changes to vehicle emission standards and lower automobile exports (Figure 2.8). Automobile export demand is likely to remain constrained, with further downside risks from potential US import tariffs on EU cars. This is reflected in unfavourable PMI readings.

Following the European Central Bank's policy meeting in September, the bank cut its benchmark deposit rate by 10 basis points to -0.5 per cent. In November, the central bank eased monetary policy further, reintroducing a quantitative easing program which will involve the purchase of 20 billion euros worth of bonds a month.

These measures, combined with higher export demand, are expected to increase Eurozone growth from 1.5 per cent in 2019 to 1.7 per cent in 2021. Eurozone growth is expected to benefit from more certainty over Brexit following the decisive UK election results in mid-December.

Figure 2.8: German exports



Source: Bloomberg (2019)

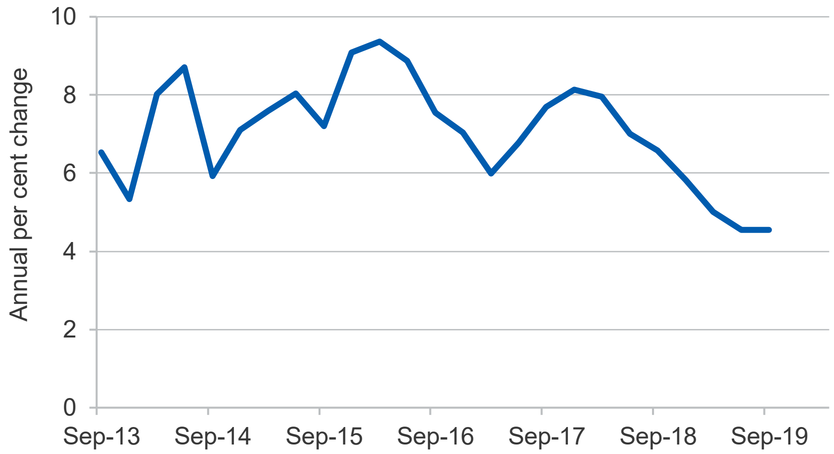
Indian economic growth has slowed

Indian economic growth slowed in 2019, affected by sluggish domestic consumption growth (Figure 2.10). This led to the Reserve Bank of India reducing official interest rates five times during 2019. The Indian Government has also introduced several fiscal stimulus policies to spur economic growth Government has also introduced several fiscal stimulus policies to spur economic growth.

Following the collapse in 2018 of Infrastructure Leasing & Financial Services (NBFCs), a major nonbank finance company in India, concerns about Indian NBFCs affected the financial sector and reduced economic activity. A subsequent surge in borrowing costs forced NBFCs to freeze, or tighten, lending.

Despite these factors, Indian economic growth in 2019 is forecast by the IMF to be around 6.0 per cent before increasing to 7.0 per cent in 2020. Growth in 2021 is forecast to increase further to 7.4 per cent. If realised, this would be the highest growth rate since 2015.

Figure 2.9: Indian GDP growth



Source: Bloomberg (2019)

Table 2.1: Key world macroeconomic assumptions

Per cent	2018	2019[a]	2020[a]	2021[a]
Economic growth[b]				
Advanced economies	2.3	1.7	1.7	1.6
Australia	2.7	1.7	2.3	2.6
Eurozone	2.2	1.5	1.6	1.7
France	1.7	1.2	1.3	1.3
Germany	1.5	0.5	1.2	1.4
Japan	0.8	0.9	0.5	0.5
New Zealand	2.8	2.5	2.7	2.6
South Korea	2.7	2.0	2.2	2.7
United Kingdom	1.4	1.2	1.4	1.5
United States	2.9	2.4	2.1	1.7
Emerging economies	4.5	3.9	4.6	4.8
ASEAN-5[d]	5.2	4.8	4.9	5.2
China[e]	6.6	6.1	5.8	5.9
Chinese Taipei	2.6	2.0	1.9	2.1
Emerging Asia	6.4	5.9	6.0	6.2
India	6.8	6.1	7.0	7.4
Latin America	1.0	0.2	1.8	2.4
Middle East	1.4	1.3	3.2	2.8
World[c]	3.6	3.0	3.4	3.6

Notes: a Assumption; b Year-on-year change; c Weighted using purchasing power parity (PPP) valuation of country gross domestic product by IMF; d Indonesia, Malaysia, the Philippines, Thailand and Vietnam; e Excludes Hong Kong

Source: IMF (2019) World Economic Outlook; Department of Industry, Innovation and Science (2019)

Table 2.2: Exchange rate and inflation assumptions

	2018	2019	2020	2021
AUD/USD exchange rate	0.78	0.72	0.70	0.73
Inflation rate				
United States	2.4	1.7	2.1	2.1
	2017–18	**2018–19**	**2019–20**	**2020–21**
Australia	1.9	1.6	1.7	1.9

Notes: The inflation rate for Australia is used to convert Australian export values to real 2019–20 dollars.
The inflation rate for the United States is used to convert commodity prices denominated in USD to real 2019 dollars.

Source: Department of Industry, Innovation and Science (2019); Bloomberg (2019) Survey of economic forecasters