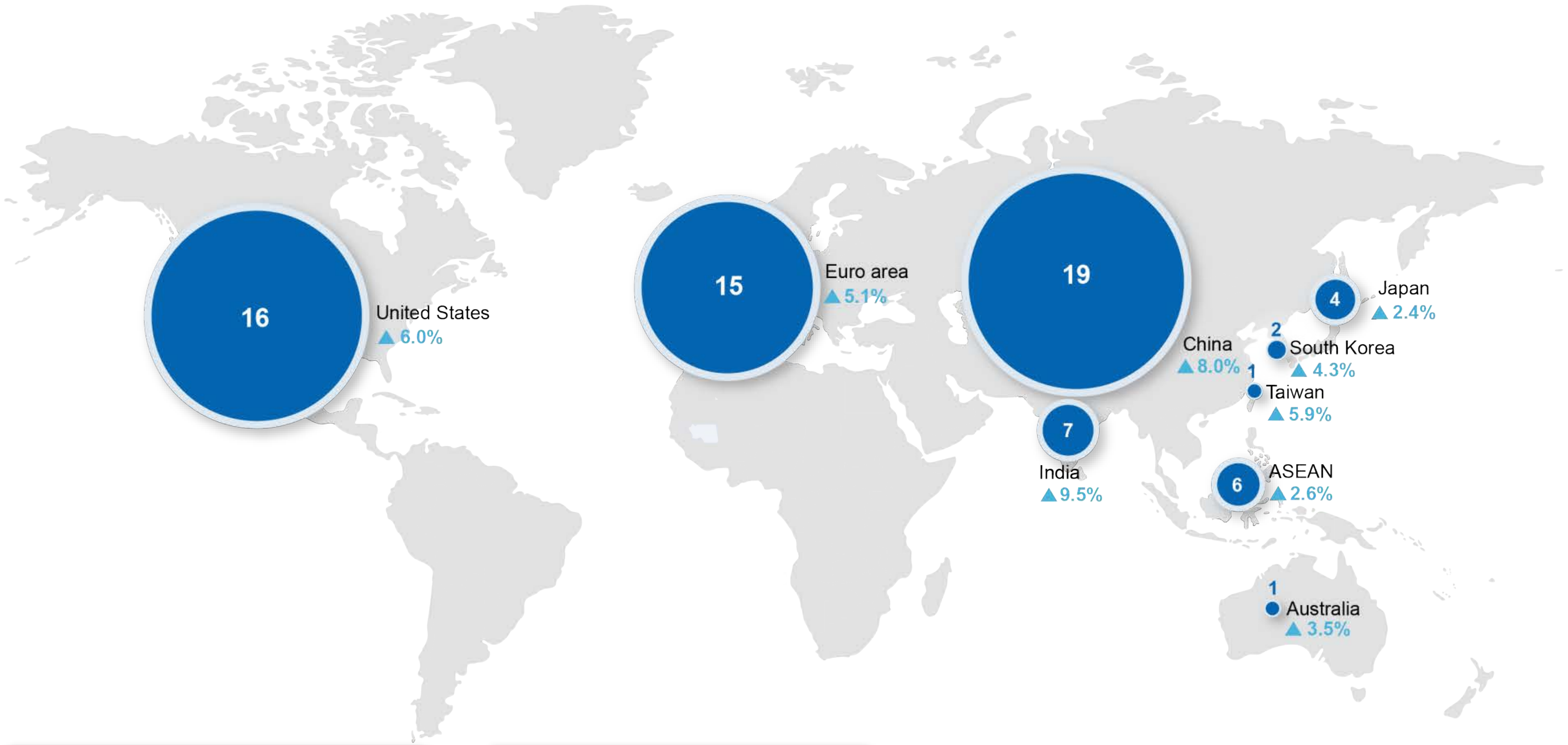
Macroeconomic Outlook



In 2020, world economic growth contracted by 3.1% due to COVID-19. Increasing containment of COVID-19 and economic stimulus are expected to support growth of 5.9% in 2021.

Risks include slow or limited vaccine rollouts, as well as additional COVID-19 strains. Over the medium term rising inflationary pressures pose a risk.

2.1 Summary

- The global recovery continues, sustained by the ongoing rollout of COVID-19 vaccines and continued fiscal and monetary support across major economies.
- However, the pace of recovery has slowed in recent months. While this follows a moderation of growth rates toward long-run trend levels as the recovery progresses, it also reflects near-term impacts from the pandemic. This includes renewed outbreaks of COVID-19 and energy shortages across many regions, and ongoing supply chain disruptions.
- After growth of 5.9% in 2021, world economic growth is forecast to ease to 4.9% in 2022 and 3.6% in 2023, as levels of pent up demand recede, and governments and central banks continue to withdraw stimulus policies.

2.2 World economic outlook

Global recovery remains underway, despite ongoing impacts of pandemic

In its October 2021 Outlook, the International Monetary Fund (IMF) projects the world economy to grow by 5.9% in 2021 (Figure 2.1). This is a slight downward revision (of 0.1 percentage points) from its July 2021 update. The revised projection accounts for the impact of the recent waves of the pandemic across many regions, as well as the persistence of global supply chain constraints, as the global demand for goods has recovered to pre-pandemic levels.

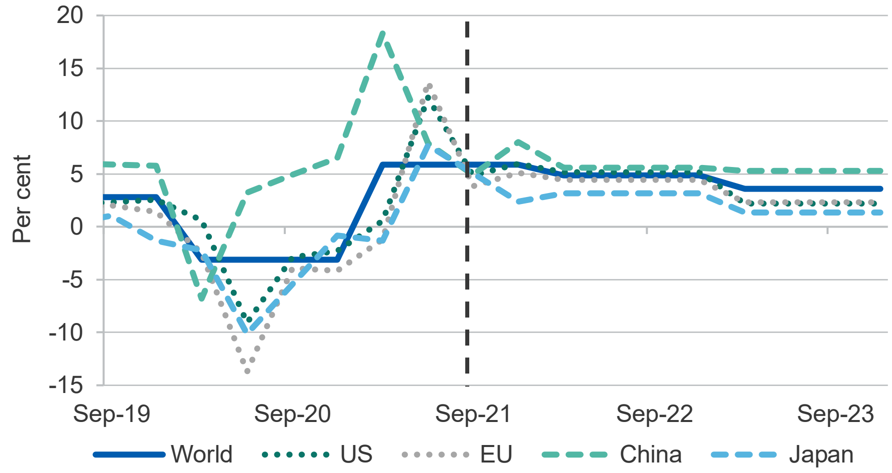
The IMF has highlighted the key role that (disparities in) vaccination rates continue to play in the diverging recoveries seen across different countries and regions. Advanced economies — with almost 60% of their populations fully vaccinated by the end of October — are expected to return to their pre-pandemic trend growth path by 2022. In comparison, output in emerging market and developing economies is now expected to be 5.5% below the pre-pandemic forecast in 2024.

Amongst advanced economies, the US, Germany and Japan have had 2021 growth projections revised down from the July 2021 Outlook, due to near-term impacts of the pandemic. However, advanced economies are expected to make a stronger recovery in the first half of 2022, as vaccination rates improve. China's projected growth has also been revised down in both 2021 and 2022 (by 0.1 percentage points), due to a stronger-than-expected scaling back of fiscal support this year.

Ongoing fiscal and monetary accommodation continues to be a driver of the faster recovery of many advanced economies. Significant fiscal packages in economies such as the US, EU, United Kingdom and Japan, are expected to continue to offset ongoing COVID-19 impacts, and boost economic growth into 2022.

World economic growth is expected to moderate over the outlook period. Global growth is forecast to reach 4.9% in 2022, with a further easing to 3.6% in 2023, as pent up demand in the global economy recedes and government support is removed. However, there remain significant risks to this recovery path. Renewed waves of the pandemic have contributed to lower global growth in the September and December quarters of 2021, and remain a risk to ongoing recovery in the near-term. Supply chain

Figure 2.1: GDP growth forecasts



Source: Bloomberg (2021); IMF (2021)

constraints are also creating inflationary pressures that could hamper global growth over the outlook period. An emerging risk is the impact of Chinese policy measures adopted in 2020 and early 2021, aimed at deleveraging its residential property sector — though there are recent signs these measures are now starting to be wound back.

Strong growth in global trade and production expected despite disruptions

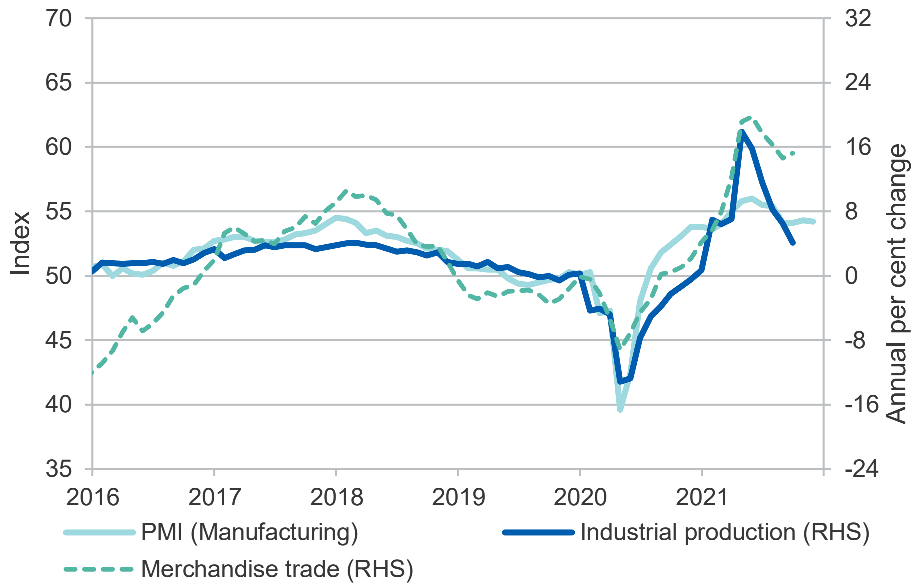
The outlook for Australia's major trading partners remains positive, with growth forecast to reach 6.0% in 2021 and 5.0% in 2022. In its October 2021 Outlook, the World Trade Organisation predicts merchandise trade volumes to grow by 10.8% in 2021, a significant upward revision from 8.0% forecast in March this year.

This improved outlook comes despite a number of supply-side issues that have intensified through 2021. For example, the current shortage in semiconductor chips is now expected to persist into 2022. Supply chain disruptions (such as port delays and container shortages) and high shipping costs are all also stunting the recovery in global trade. These issues have seen a marginal slowing of growth in merchandise trade in recent months, falling from a peak of 20% year-on-year in April 2021, to 15% year-on-year in September 2021 (Figure 2.2).

Global industrial production has rebounded impressively in 2021, and was 4.1% higher year-on-year in September (Figure 2.2). However, the rate of recovery also appears to be slowing, with global industrial output in the September quarter falling 0.2% quarter-on-quarter. While this is consistent with a return to more moderate, longer-run growth rates, it also reflects near-term disruptions that have persisted in many nations in 2021 as a result of the COVID-19 pandemic and supply chain issues.

The Global Manufacturing Purchasing Managers Index (PMI) was 54.2 in November, marking improved business conditions for 17 consecutive months. However, firms continue to report rising inputs costs (near their highest ever levels), stalled international trade flows, and supplier delays — which reached their highest levels on record in October.

Figure 2.2: World industrial production, trade and PMI



Notes: PMI data is to November 2021; IP and trade data only available to September 2021
Source: IHS Markit (2021); CPB Netherlands Bureau for Economic Policy Analysis (2021)

Global services trade — while still below pre-pandemic levels — has seen continued improvement in recent months, and is helping to offset the weaker expansion in merchandise trade. This includes strong growth in the business, consumer and financial services sectors. As COVID-related movement restrictions ease in many countries, services activity, commuting and leisure travel, are all expected to continue strength growth into 2022. However, services industries remain susceptible to renewed outbreaks over the outlook period.

Ongoing global supply chain disruptions increasing inflationary pressures

The robust recovery in world trade and industrial production in 2021 has continued to put pressure on global supply chains, as the rebound in global demand has consistently outpaced the recovery in supply.

The comparatively stronger financial position of many households in advanced economies coming out of the pandemic — due to sizeable fiscal support, increased household savings rates, and growth in asset prices — has seen a significant surge in global consumption levels. This has been further propelled by the shift in household preferences toward goods consumption since the start of the pandemic.

However, renewed outbreaks of the COVID-19 pandemic — particularly in Asia — continued to stifle global supply chains in the second half of 2021. Port delays, high shipping costs and other transportation shortages are all also creating persistent disruptions to the global recovery.

The current shortage in semiconductor chips provides a notable example of the impacts from these disruptions. Estimates suggest the shortage will lead to 7.7 million fewer vehicles being made in 2021, and cost the automotive industry more than $200 billion in lost revenue. Impacts have also affected other industries such as medical equipment, computers, and other electronics. The shortage is now expected to persist well into 2022.

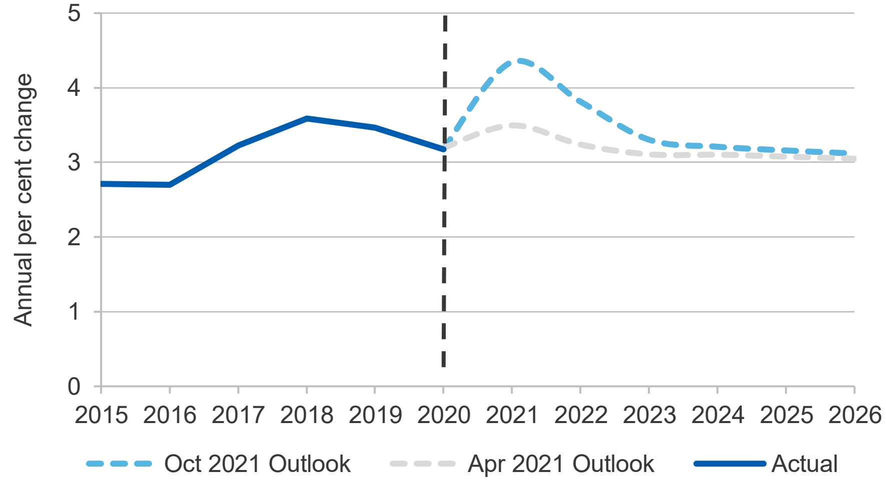
Congestion at major destination ports in Europe and the US has also intensified in recent months, contributing to increased delivery delays and rising input costs. In October, average vendor delivery times (measured through the JPMorgan Global Manufacturing PMI) were the longest on record. Combined with other cost pressures, this has led to input prices increasing at their fastest pace in over a decade (Figure 2.3).

The persistence of price pressures has caused the IMF to increase its inflation projections in its most recent Outlook. Inflation is now forecast to reach 4.3% in 2021, and 3.8% in 2022 (Figure 2.4). Inflationary pressures have also prompted a number of central banks to begin normalising monetary policy. Central banks in the Czech Republic, Poland and South Korea have all raised rates in recent months. And the Bank of England and Bank of Canada have also flagged potential interest rate increases in the next few quarters, raising the risk of potential checks to the pace of the global recovery over the outlook period.

Figure 2.3: Producer Price Indices – US, China and Eurozone

Source: Bloomberg (2021); Board of Governors of the Federal Reserve System (2021); U.S. Bureau of Economic Analysis (2021)

Figure 2.4: IMF projections of global inflation



Source: IMF (2021)

2.3 Major trading partners' economic outlook

China's recovery hindered in Q3 by new outbreaks and energy shortages

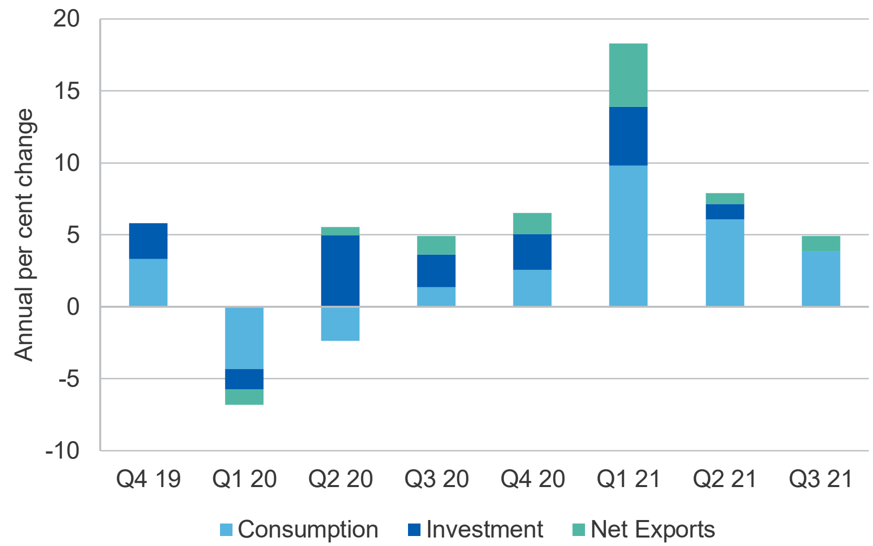
China's economy grew by 4.9% year-on-year in the September quarter 2021, its slowest rate of growth in over 12 months. Renewed outbreaks of the pandemic have impacted economic activity in recent months, along with acute energy shortages and policy decisions aimed at deleveraging the domestic property sector (see *Steel* chapter). Growth in the September quarter 2021 was primarily driven by domestic consumption (public and private combined) and exports (Figure 2.5). By industry, sectors such as Information Technology (17.1% growth year-on-year) and Wholesale and Retail Trade (7.6% year on year) saw the biggest expansions.

The considerable surge in China's industrial output in the first half of 2021 — as the country emerged from the pandemic — now appears to be easing. Industrial production grew by 3.5% year-on-year in the month of October, down from a high of 14% in March 2021. Sentiment improved in China's official manufacturing PMI in November, reaching 50.1 and marking a reversal from the contraction (readings below 50) seen for the two previous months. However, the Caixin-Markit Manufacturing PMI — a broader-based survey of over 500 companies — fell into contractionary territory in November, with a reading of 49.9.

Chinese manufacturers have highlighted the deleterious impact that power shortages and rising costs have had on industrial output in recent months. Coal shortages have led to power rationing and forced blackouts in more than half of China's 31 provinces from September this year, severely restricting the country's industrial activity during the period (see *Thermal Coal* chapter). While the shortages appear to have relented as of late November, inflationary pressures are expected to remain elevated in the short term. Lead times for inputs in October increased at their fastest rate since March 2020, and input costs rose for the 17th consecutive month.

The September quarter 2021 also saw a contraction in China's construction and real estate sectors (-1.8 and -1.6% year-on-year respectively). This follows recent efforts by the central government to

Figure 2.5: Contributions to China's quarterly real GDP growth



Notes: Consumption is made up of both household and government sectors.
Source: Bloomberg (2021); National Bureau of Statistics of China (2021)

deleverage the residential property market. The introduction of the 'Three Red Lines' policy in late 2020 has seen investment in real estate weaken in 2021 and a number of private developers face funding pressures during the year, most notably China Evergrande. Following falls in property prices and construction starts in recent months, the government and central bank have intervened to stem the weakness in the sector. However, a downturn in residential activity remains a risk over the outlook.

The slowdown in economic growth in the September quarter 2021 and ongoing concerns about China's property sector has seen growing market expectations of a return of fiscal and monetary stimulus — particularly infrastructure investment — in the near term. However, at the end of October total infrastructure investment (three month moving average, year-on-year) was 5.3% lower than 12 months previous. And Total Social Financing — a broad measure of credit and liquidity in the economy — in the 10 months to October 2021 was also around 15% lower than the same period in 2020.

Following recent outbreaks of the pandemic in the second half of 2021, as well as the continued removal of fiscal stimulus, the latest IMF forecasts put China's growth at 8.0% in 2021. This is a 0.1 percentage point reduction compared with the IMF's July 2021 Outlook. China's economic growth is then forecast to ease to 5.6% in 2022. Renewed outbreaks of the pandemic remain a significant downside risk in the near term. High case numbers in October and November — affecting more than half of China's 31 provinces — could stymie growth further in coming months. A resumption of energy shortages, or a deterioration in China's residential property market could also impact on growth over the outlook.

Recent wave of COVID-19 and supply shortages delay Japan's recovery

Due to a severe wave of the COVID-19 pandemic through the summer, Japan's economy contracted by an annualised 3.6% year-on-year in the September quarter 2021. This was also the fifth contraction of the Japanese economy (quarter-on-quarter) in the last eight quarters.

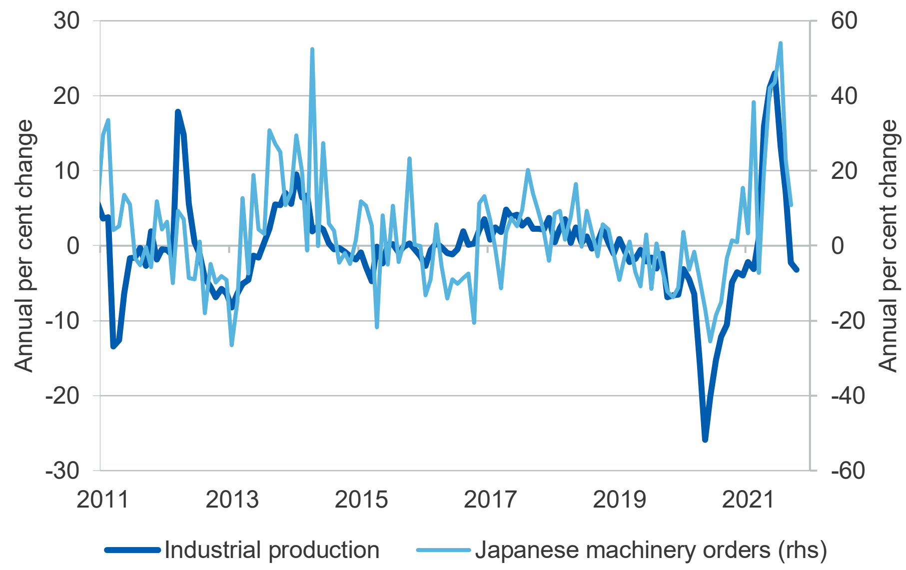
After a rapid expansion in the first half of 2021, industrial production fell 3.2% year-on-year in October 2021. This follows slowing growth in machinery orders and exports in recent months (Figure 2.6). Despite the recent contraction in output, lead indicators continue to suggest a positive outlook for economic activity in the December quarter 2021, as COVID-19 case numbers fall and containment measures are relaxed. The Jibun Bank Manufacturing PMI for Japan rose to 54.5 in November (from 53.2 in September), marking 10 consecutive months of expansion. Jibun Bank's Japan Services PMI also returned to expansionary territory for the second consecutive month, reaching 53.0 in November. This included business activity rising at its fastest pace for 27 months.

Manufacturers continue to highlight the presence of considerable supply chain issues and the inflationary pressures this is creating. Raw material shortages have led to a sharp increase in input prices in recent months, and have contributed to factory gate inflation reaching 13-year highs.

Many firms are also flagging the potential for rising staff costs over the coming 12 months.

The IMF is now projecting Japanese economic growth of 2.4% in 2021. This is a fall of 0.4 percentage points from the July 2021 Outlook, reflecting the impacts of the COVID-19 pandemic through the September quarter 2021. However, Japan is expected to see a stronger rebound in coming quarters, as vaccinations are rolled out and the economy returns to normal, with the IMF forecasting growth to reach 3.2% in 2022, before slowing to 1.4% in 2023. The recovery will be further aided by an additional ¥78.9 trillion (around US$690 billion) stimulus package unveiled by Prime Minister Kishida in the second half of November.

Figure 2.6: Japan industrial production and machinery orders



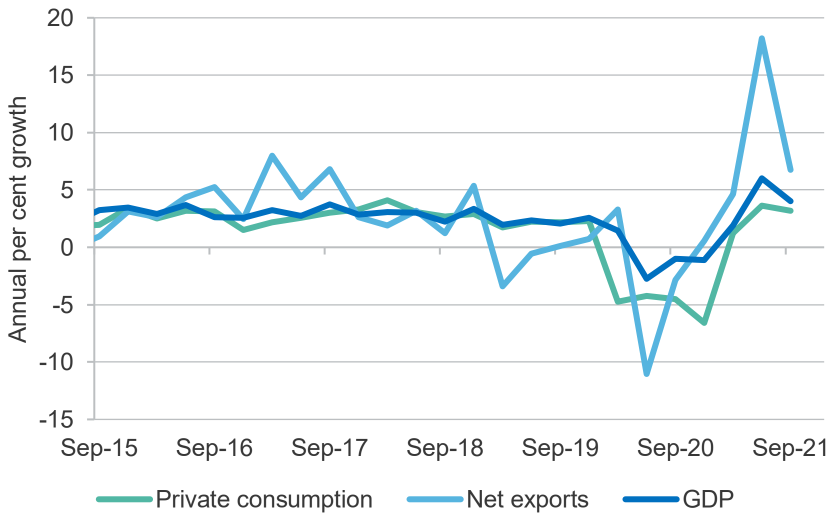
Notes: IP data is to October 2021; machinery orders data only available to September 2021
Source: Bloomberg (2021)

Softer growth for South Korea in Q3 on renewed COVID-19 outbreaks

South Korea's economy grew by 4.0% year-on-year in the September quarter 2021. The softening pace compared with the June quarter 2021 (6.0% growth year-on-year) follows renewed outbreaks of the pandemic and strict containment measures instituted from July this year (Figure 2.7). Exports continued to help to drive growth in the South Korean economy in the September quarter, with growth in net exports of 6.8% year-on-year. Household demand also remained resilient, growing 3.2% year-on-year.

The renewed COVID-19 outbreaks has led to weakness in the manufacturing sector, with industrial production falling by 1.9% year-on-year in the month of October. South Korea's manufacturing PMI reading in November was 50.9, a slight improvement on October (at 50.2), however marked a second consecutive decrease in manufacturing output. Firms have highlighted raw material shortages and ongoing supply chain issues as having contributed to a broad stagnation in operating conditions.

Figure 2.7: South Korean GDP, consumption and trade



Source: Bloomberg (2021)

Despite the softer pace of recovery, rising price pressures have seen the Bank of Korea begin to raise policy rates, with a 25 basis points increase in both August and November this year. Against a back drop of comparatively high levels of household debt (amongst advanced economies), managing this normalisation of monetary policy and maintaining economic activity and sentiment presents a key challenge over the outlook period.

The IMF forecasts South Korea's economy to grow by 4.3% in 2021, and 3.3% in 2022, sustained by the ongoing recovery of global economic activity and trade. This is unchanged from the IMF's July 2021 Outlook. South Korea's economic growth is then forecast to ease to 2.8% in 2022. Renewed outbreaks of the pandemic — and its impact on global demand for goods amongst South Korea's major trade partners — will continue to be a key risk for the economy in the December 2021 quarter and into 2022.

India's recovery slows in Q3 due to fading base effects and weaker output

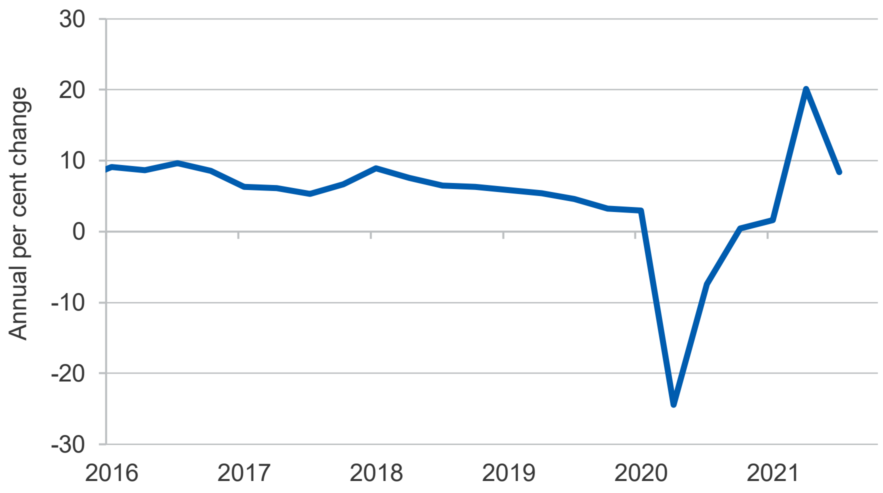
Following a record pace of expansion in the first quarter of India's new financial year (April – June 2021), India's growth has slowed to 8.4% year-on-year in the September 2021 quarter (Figure 2.8). This reflects a fading base effect — with the fall in economic activity most acute in the June quarter 2020 — as well as softening domestic demand and merchandise exports.

While the pace of growth has eased, India's economy continues to steadily recover, as COVID-19 cases drop and mobility and activity in the services sector recovers. India's manufacturing industry — which contributes around 16% of the country's GDP — grew by 5.5% year-on-year ib the September 2021 quarter. Over the same period, the Trade, Hotels, Transport & Communication industry (around 17% of the country's GDP) grew by 8.2% year-on-year, and construction (around 7% of GDP) grew by 7.5%.

Following rapid expansion in industrial activity in the first half of 2021, growth in industrial production in October has slowed to 3.1% year-on-year, with weaker output in industries such as mining and quarrying, manufacturing and utilities. This is due to a number of rising supply side issues, most notably a severe power shortage from shortages of thermal coal (see *Thermal Coal* chapter).

Despite the recent disruptions, the business outlook remains positive, with India's composite PMI in October (combining manufacturing and services) reaching its highest level since 2012. India's manufacturing PMI has further increased in November, with a reading of 57.6. This marked five consecutive months of expansion. Manufacturing activity is expected to continue expanding into the end of 2021, with stronger business confidence and a pick-up in new orders. However, rising input costs remain a growing concern for Indian manufacturers, increasing in recent months at their fastest rate in close to 8 years. These costs have mostly not been passed on yet (in the form of output cost rises) containing inflation for the time being, though the risk remains.

Figure 2.8: India quarterly GDP



Source: Bloomberg (2021)

India's Services PMI has also recorded its third fourth consecutive month of expansion, with a reading of 58.1 in November. While this marks a slight slowing in pace from October, it remained the second fastest rate of expansion in over a decade, and follows a reopening of the economy and renewed mobility. Indian services firms have continued to identify elevated input cost pressures, with higher fuel, material, staffing and transportation costs. Firms have also indicated that a growing share of the high cost burden firms, with a larger share of cost burdens now being passed to customers.

The IMF forecasts India's economic growth at 9.5% in 2021, unchanged from its July 2021 Outlook. This reflects expectations of a stronger recovery from the second half of 2021, as market confidence and demand conditions rebound. India's economy is subsequently forecast to grow by 8.5% in 2022 and 6.6% in 2023.

Slowing US growth in Q3, due to disrupted supply and weak consumption

The pace of US recovery eased in the September quarter 2021, with the economy growing at an annualised rate of 2.1%. This follows a new wave of the pandemic from the late summer, intensifying supply chain issues, and a marked weakening in the level of household consumption.

The release of pent up demand was a major driver of the US recovery in the first half of 2021, with household spending for both goods and services exceeding their pre-pandemic levels by June this year (Figure 2.9). While initially supported by a number of rounds of fiscal stimulus spending, record levels of private savings accumulated during the pandemic (close to US$4 trillion as of March 2021) also contributed to the significant rise in household consumption in recent quarters.

However, private consumption has slowed considerably in the September quarter 2021, growing by just 1.6% on an annualised basis (compared with 12% growth in the June 2021 quarter). This follows a further wave of the COVID-19 pandemic through the late summer, and the drawdown of household savings.

The release of pent up demand in the first half of the year contributed to the significant and ongoing supply chain disruptions seen through 2021. The backlog of cargo ships at many US ports remain at historic highs, and labour shortages in the transportation and logistics sectors are exacerbating issues with destination supply chains.

This has led to growing shortages of goods, and spiking prices. With much of the release of pent up demand and net private savings now returning longer-run levels, growth in household demand for goods is expected to ease from its elevated levels going into 2022.

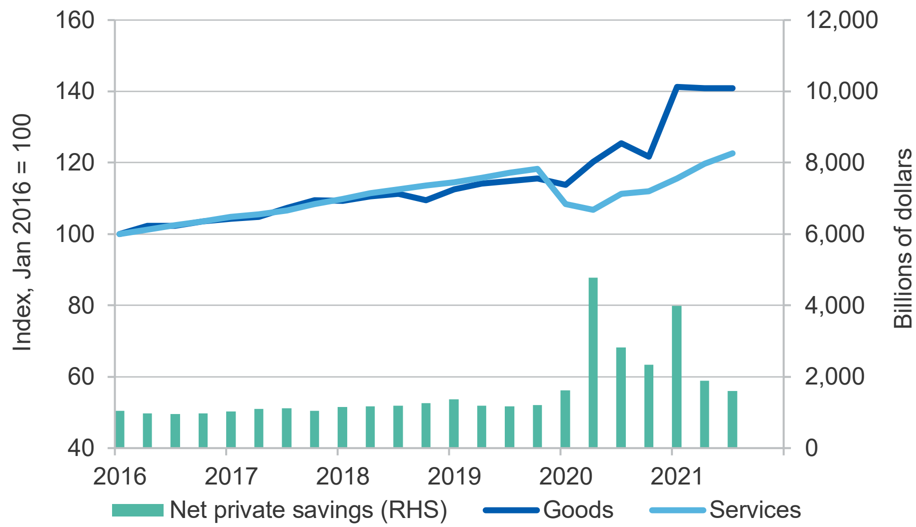
US industrial output expanded by 5.1% in the month of October, however this marked six months of slowing growth. The US Manufacturing PMI index remained in expansionary territory (with a reading of 58.4) in November, but was the second weakest rise in production over the past 14 months. Severe supplier delays and a shortage of components continues to constrain output, with significant numbers of manufacturers citing constrained production. This has led to a record rise in output prices, suggesting inflationary pressures are unlikely to abate in the next few months.

After contracting 3.4% in 2020, the IMF forecast US economic growth at 6.0% in 2021. This is a reduction of 1.0 percentage point compared with the July 2021 Outlook. The downward revision was due to softening consumption in the September quarter 2021 and ongoing supply chain disruptions. Projected growth in 2022 has increased to 5.2% and 2.2% in 2023, following President Biden signing the US$1.2 trillion Infrastructure Investment and Jobs Act into law in early November (see *Steel* chapter). Together with the proposed Build Back Better Framework currently under consideration in the US Senate, this would mean around $4 trillion in additional government spending over the next 10 years.

Europe recovery hampered by supply chain disruptions

Increasing vaccination rates and the reopening of economies saw the EU recovery continue in the September quarter 2021, with the economy

Figure 2.9: US personal consumption and net private savings



Notes: Personal Consumption Expenditures; seasonally adjusted data; January 2016 =100

Net private saving: Households and institutions, Billions of Dollars, Quarterly (End of quarter), Seasonally Adjusted Annual Rate

Source: U.S. Bureau of Economic Analysis (2021)

growing by 2.1% quarter-on-quarter (Figure 2.10). This put growth at 3.9% year-on-year, down from 13.7% in the June quarter.

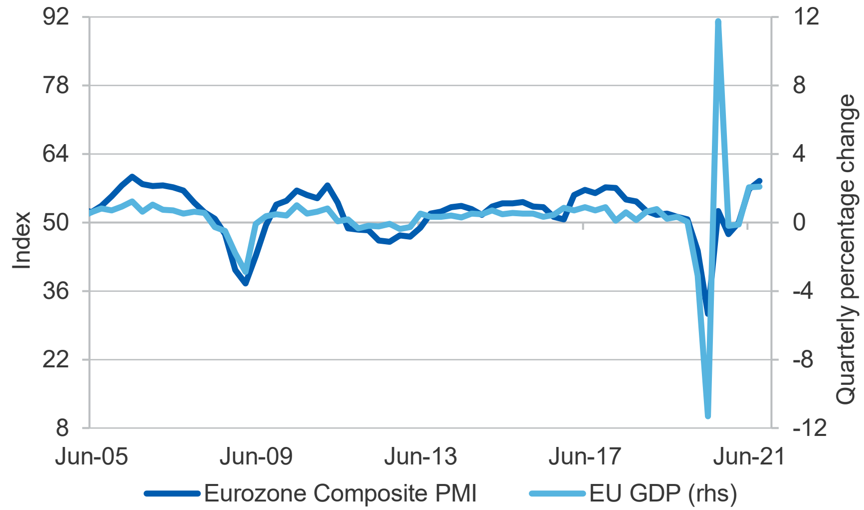
Accommodative fiscal policies and COVID-19 support schemes have helped to support employment and bolster household balance sheets throughout the COVID-19 pandemic. However, rising case numbers and uneven vaccination rates across Eurozone member countries going into the December quarter 2021 means continued risk to the European recovery in the near-term.

The Eurozone PMI Services Business Activity Index reading was 56.6 in November, marking a three month high. Prolonged supply disruptions and high energy prices have also impacted the European economy in recent months. Headline inflation in the Eurozone reached 4.1 percent (year-on-year) in October 2021. Energy prices have been the major driver of these inflationary pressures, with shortages of oil and gas leading to prices hitting multi-year highs in recent months (see *LNG* chapter).

The strong rate of recovery in manufacturing in Europe is passing — with industrial production in the Eurozone falling by 0.2% month-on-month in September. This saw industrial output on an annualised basis also fall from 8.0% to 5.1% over the same period. The Eurozone Manufacturing PMI reading of 58.4 in November marked a small rebound from October, which had seen the weakest rate of expansion since February 2021. Producers have reported a worsening of supply chain issues in recent months, including a lack of shipping containers, port congestion and driver shortages. This has led to the weakest rise in output in over 12 months, and inflationary pressures reaching new highs.

The IMF now forecasts Eurozone economic growth at 5.0% in 2021, a 0.4 percentage point increase from its July 2021 Outlook. This reflects the improving health situation and easing of containment measures from the June and September quarters. Beyond 2021, the speed of the recovery is forecast to normalise, with growth of 4.3% projected in 2022 and 2.0% in 2023.

Figure 2.10: Eurozone GDP and Composite PMI (quarterly)



Source: Bloomberg (2021)

Table 2.1: Key IMF GDP assumptions

	2020	2021[a]	2022[a]	2023[a]
Economic growth[b]				
Advanced economies	-4.5	5.2	4.5	2.2
– Australia	-2.4	3.5	4.1	2.6
– European Union	-5.9	5.1	4.4	2.3
– France	-8.0	6.3	3.9	1.8
– Germany	-4.6	3.1	4.6	1.6
– Japan	-4.6	2.4	3.2	1.4
– New Zealand	-2.1	5.1	3.3	1.7
– South Korea	-0.9	4.3	3.3	2.8
– United Kingdom	-9.8	6.8	5.0	1.9
– United States	-3.4	6.0	5.2	2.2
Emerging economies	-2.1	6.4	5.1	4.6
– ASEAN-5[d]	-3.4	2.9	5.8	6.0
– China[e]	2.3	8.0	5.6	5.3
– India	-7.3	9.5	8.5	6.6
– Latin America	-7.0	6.3	3.0	2.5
– Middle East	3.2	2.8	2.8	2.8
World[c]	-3.1	5.9	4.9	3.6

Notes: a Assumption; b Year-on-year change; **c** Calculated by the IMF using purchasing power parity (PPP) weights for nominal country gross domestic product; **d** Indonesia, Malaysia, the Philippines, Thailand and Vietnam. **e** Excludes Hong Kong.
Sources: Bloomberg (2021); Department of Industry, Science, Energy and Resources (2021); IMF (2021)

Table 2.2: Exchange rate and inflation assumptions

	2020	2021[a]	2022[a]	2023[a]
AUD/USD exchange rate	0.69	0.75	0.73	0.75
Inflation rate[b]				
United States	1.2	3.7	3.5	2.7
	2019–20	**2020–21[a]**	**2021–22[a]**	**2022–23[a]**
Australia[e]	1.6	2.4	2.2	2.3

Notes: a Assumption; b Change from previous period; **c** Calculated by the IMF using purchasing power parity (PPP) weights for nominal country gross domestic product; **e** Average of daily rates.
Sources: ABS (2021) Consumer Price Index, 6401.0; Bloomberg (2021); Department of Industry, Science, Energy and Resources; RBA (2021) Reserve Bank of Australia Bulletin; IMF (2021).