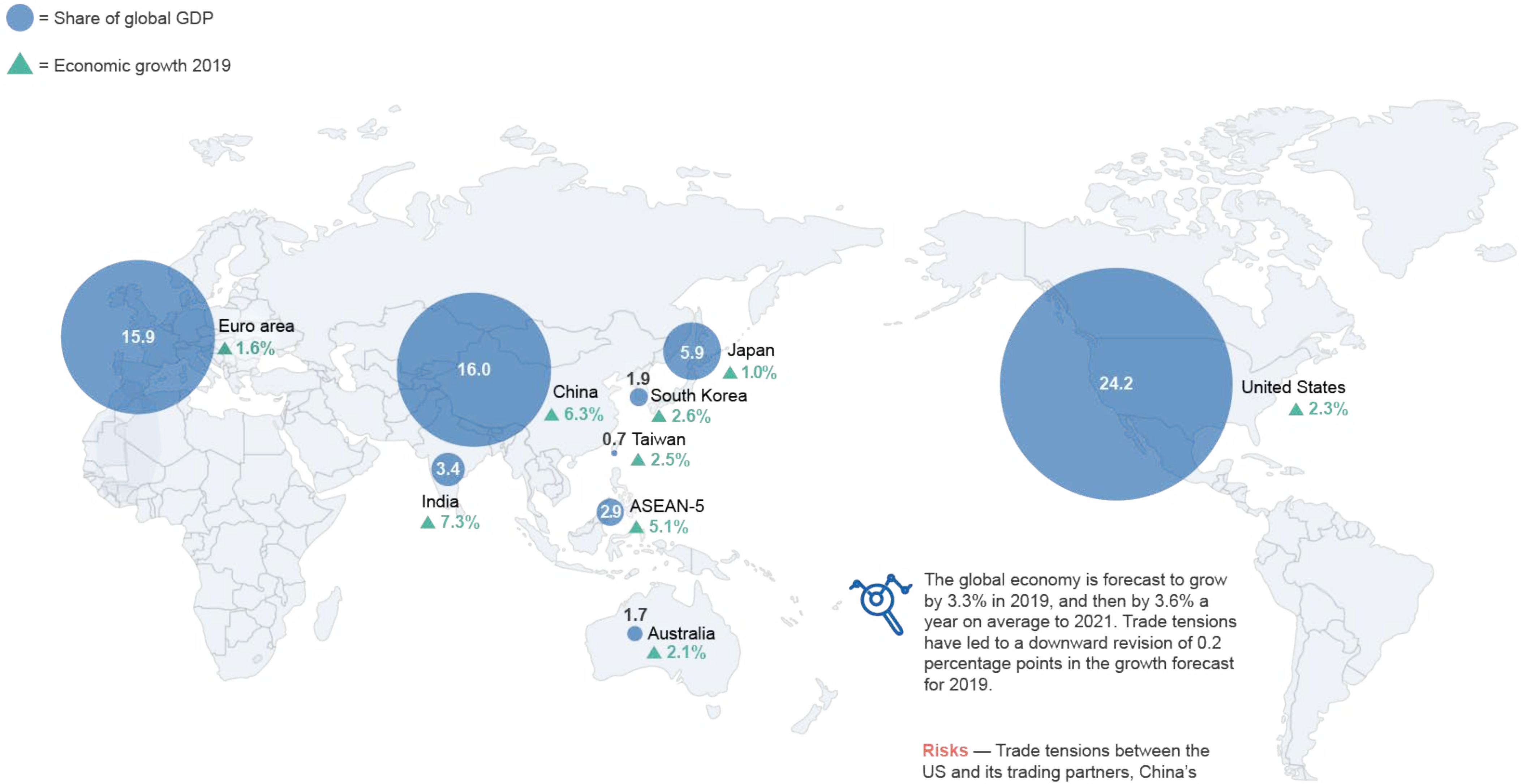
Macroeconomic Outlook

Resources and Energy Quarterly June 2019



The global economy is forecast to grow by 3.3% in 2019, and then by 3.6% a year on average to 2021. Trade tensions have led to a downward revision of 0.2 percentage points in the growth forecast for 2019.

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

2.1 Summary

- The IMF forecasts global economic growth of 3.3 per cent in 2019, and by 3.6 per cent in 2020 and 2021. Global industrial production and trade figures declined in late 2018 and early 2019, but appear to be stabilising.
- Trade tensions between the US and China represent the largest risk to the outlook, with a resolution seemingly unlikely in the near future. Significant stimulus measures are being implemented in China in an attempt to offset the economic impacts of trade tensions.

2.2 Global economy

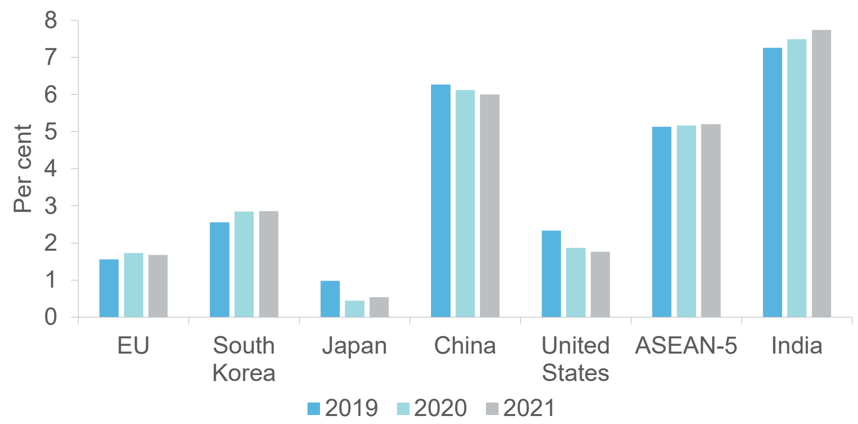
The global economy has grown for nine years without a recession, but risks and tensions are now rising. GDP growth is subject to a mixed and softening outlook among most countries (Figure 2.1).

The upsurge of trade tensions between the US and China presents the most significant risk to the global outlook. After China reversed its previous support for parts of a nascent trade agreement, the US announced in early May that tariffs on US$200 billion of Chinese imports would be raised from 10 per cent to 25 per cent. China countered with penalties against $US60 billion of imports from the US. The measures will affect a range of commodity-intensive technologies, including consumer goods, solar, wind and power storage technology, metals used in high-tech goods production, and materials used to store and transport natural gas.

Negotiations have so far spanned more than a year, and are currently stalled, with a number of contest points yet to be resolved. It is unclear whether any settlement will be reached in the near-term, amid increasingly bipartisan US support for a harder position against China. Global trade fell sharply at the end of 2018 as trade tensions intensified, before stabilising in mid-2019.

Chinese exports remain relatively solid overall, albeit with a sharp decline in sales to US markets. Overall exports from the US have also proven relatively resilient. In both cases, it appears that exporters are having some success in reaching alternative markets.

Figure 2.1: GDP forecasts



Source: International Monetary Fund (2019); Department of Industry, Innovation and Science (2019)

Figure 2.2: Global GDP and industrial production growth

Source: Markit (2019)

Trade tensions and a cyclical global slowdown have taken a toll on the global manufacturing Purchasing Managers Index (PMI), which fell to 49.8 in May 2019 as manufacturing activity contracted. This continues a slow decline from a peak of above 54 at the start of 2018 — with the pace of this decline picking up recently. Most countries have recorded significant downward movements in leading indicators of activity in recent months.

Global industrial production growth also eased, as trade difficulties added new uncertainties to global production chains (Figure 2.2). While some forecasters expect industrial production to recover in coming quarters, a potential escalation in trade tensions represents a significant risk.

Global demand for manufactured electronics has been hit particularly hard in recent months, and may now be moving into a downward cycle. Manufacturers in emerging Asia may be forced to wind back commodity imports as a result. Higher-value products, including batteries, may also be affected in the near future, though tariffs are yet to target these products.

Rare earth minerals, which are essential to many industrial and non-industrial applications, also remain exempt from US tariffs at present. Some medial reports suggest that China — the largest supplier of rare earths — could cut off exports to the US and countries supplying US manufacturers. This may impact on manufacturing of a wide range of high-tech goods.

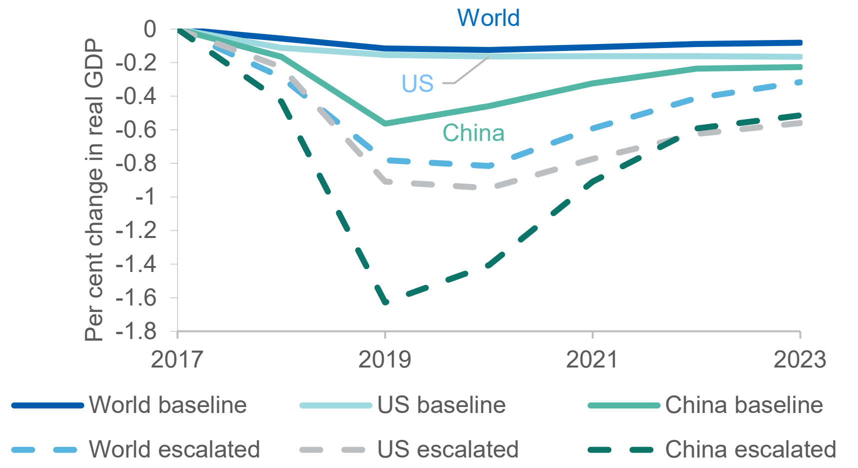
The US Administration has commenced a process examining the extension of tariffs to a further US$300 billion per year of imports from China, which would effectively cover all remaining trade between the two countries.

Trade tensions have led to series of economic stimulus measures in China. These include tax cuts worth almost US$300 billion, with the bulk of the cuts targeting businesses. The People's Bank of China has cut bank reserve requirements, reducing financial costs for small and medium businesses. Chinese officials are seeking to fast-track large scale investment projects, and have allowed local governments to release more than US$300 billion in bonds to fund new infrastructure. Also under consideration are plans to stimulate the automotive sector and encourage more consumer spending. The effects of the stimulus measures are likely to rise steadily over time, peaking in 2019–20.

Consumption growth across OECD countries is holding up relatively strongly. Global labour markets remain tight, with wages growing faster in the US. Inflation remains contained in most countries, enabling central bankers to maintain stimulus. IMF projections suggest the impact of trade tensions could affect consumption more over time, especially as tariffs are now at the escalated level the IMF previously warned against (Figure 2.3).

Geopolitical problems are also adding to risk. Disputed territorial and maritime claims, combined with the ongoing militarisation of disputed features continue to be a source of tension in the South China Sea. The Middle East remains volatile, with heightened tensions involving the US and Iran, attacks on shipping in the Gulf, and ongoing conflict in Syria.

Figure 2.3: IMF projections on trade impacts



Source: IMF World Economic Outlook (2019). Implemented measures include $50 billion of tariffs on steel, aluminium, solar panels and washing machines, $50 billion and $200 billion of tariffs that have already been imposed on Chinese imports. ** Escalated measures include $267 billion of tariffs that is likely to impose on Chinese imports should the trade tensions escalate.

2.3 Country developments

The US economy seems relatively resistant to trade tensions — so far

Trade tensions and disruptions to export markets have affected production in the United States, with the US Performance of Manufacturing Index (PMI) falling from 52.6 in April 2019 to 50.5 in May 2019. Consumer spending has remained strong, and the unemployment rate has continued its nine-year decline, reaching 3.6 per cent in April.

Economic growth is projected to moderate over the outlook period, falling to 1.9 per cent by 2019 and 1.8 per cent by 2020. Much of the decline reflects the end of the fiscal boost from tax cuts, but recent downward revisions are largely a product of trade tensions. The recent lift in tariffs, and the uncertainty around a potential further escalation, may drag on consumer spending, with business investment now projected to fall marginally in 2019 and 2020.

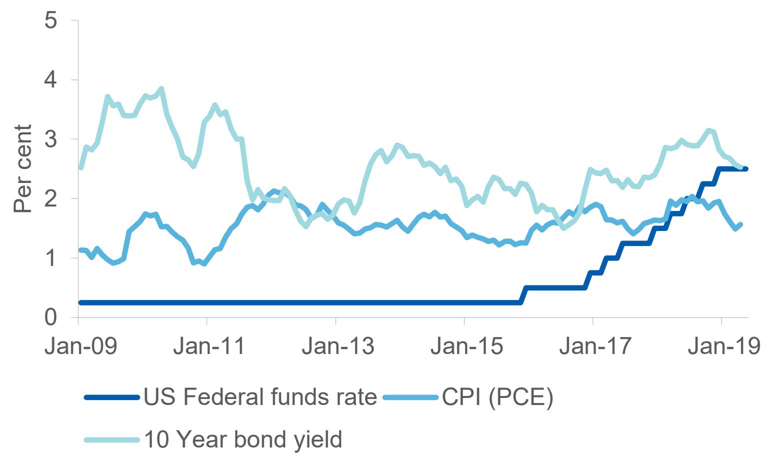
Further interest rate hikes are much less likely now as trade tensions rise. Any additional monetary stimulus is likely to drive a decline in bond yields and a relative depreciation of the US dollar. Ten year US Treasury yields have eased in recent months, falling from 2.71 per cent in March 2019, to 2.5 per cent by May, and just above 2.0 per cent in June (Figure 2.5).

Trade tensions are reinforcing a structural slowdown in Chinese growth

Revised figures suggest China's economic growth slowed to 6.6 per cent in 2018. Part of this slowdown reflects efforts by the government to reduce the environmental impact of economic activity. More stringent management of local government debt may also have constrained spending. However, US trade tensions have exacerbated these trends, leading to the lowest growth in China for almost 30 years.

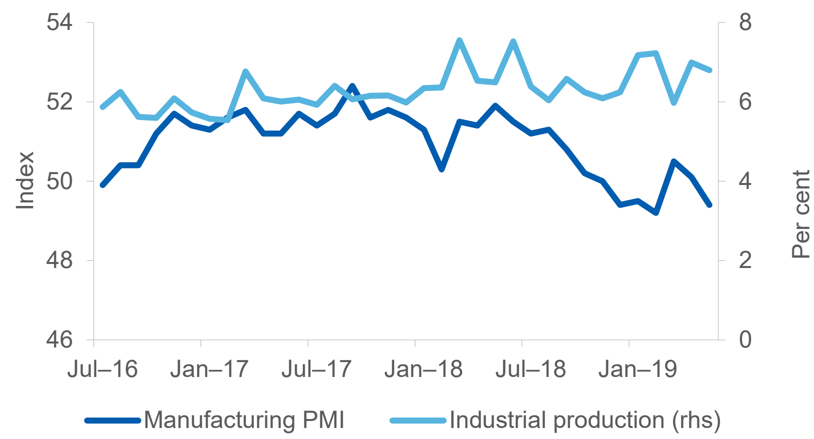
Chinese industrial production remains robust, rising by 6.8 per cent over the year to May (Figure 2.5). However, the PMI index, which is often seen as a forward indicator of manufacturing activity, suggests that activity is declining. Gradual offshoring of operations by manufacturers from

Figure 2.4: US Federal funds rate, CPI and 10-Year bond yield



Source: US Federal Reserve (2019) Federal Funds Rate; US Bureau of Labor Statistics (2019) US Personal Consumption Expenditure (PCE) Core Price Index

Figure 2.5: China's industrial production and Manufacturing PMI



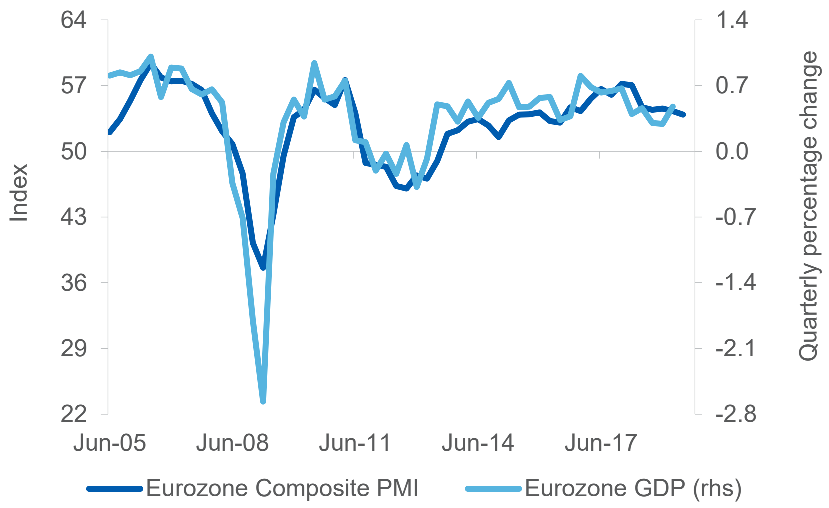
Source: Markit (2019); Netherland CPB (2019)

China to other South Asian countries (such as Vietnam) has been evident for some time, and US tariffs targeting China are likely to accelerate the pace of this trend. Chinese property markets appear to be oversupplied, affecting their ability to act as an offset to pressures elsewhere in the economy. The long-term transition towards a more consumer-driven Chinese economy is thus likely to become more important over time, with consumer spending increasingly essential to offset falls in net trade and investment. Chinese GDP growth is expected to continue easing slowly, reaching 6.0 per cent by 2021.

Europe faces sluggish growth and rising risks

Growth in the Eurozone economy in 2018 has been revised down to 2.1 per cent. This is well down from the 2017 level (2.7 per cent), and reflects rising problems among European economies, with a recession in Italy and rapid deceleration in France and Germany. Uncertainty over Brexit and contagion from the slowdown in China appear to be taking a toll. Leading indicators point to further weakening, with the manufacturing PMI

Figure 2.6: Eurozone Composite PMI and Real GDP



Source: Bloomberg (2019); International Monetary Fund (2019)

continuing to fall in mid 2019 (Figure 2.8).

Forecasts for economic growth in the Eurozone have been revised down, to only 1.6 per cent in 2019, and 1.7 per cent by 2021. Europe is likely to be weighed down by rising risks and soft performances in key economies.

Japan's GDP growth is likely to ease over the outlook period

Japan's economic growth in 2018 has been revised down to only 0.8 per cent as a result of weak consumer spending and weather disruptions. Japanese GDP is forecast to reach 1.0 per cent in 2019, before dropping to 0.5 per cent in 2020 and 2021. Labour shortages are constraining growth in some areas. Lower Chinese imports (linked to the US-China trade war) are also likely to affect net trade. Much of the decline is also linked to falling population: growth in GDP per capita is well above that of overall GDP over the outlook period.

South Korea faces mild constraints as a result of trade tensions

Like many other countries, South Korea's economic growth for 2018 has been revised down to 2.7 per cent, reflecting the impact of trade tensions late in the year. GDP fell marginally in the first quarter of 2019. Previous interest rate rises — intended to prevent capital flight to the US and cool the housing market — have dampened domestic demand slightly. Technology and advanced manufacturing exports to China have also weakened as the Chinese economy has slowed. Economic growth is projected to be pick up to 2.9 per cent by 2021, as Chinese demand recovers slightly.

India maintains one of the world's fastest economic growth rates

India's GDP grew by 7.1 per cent in 2018 — among the strongest growth rates in the world — as exports grew and reforms to simplify insolvency and bankruptcy laws took effect. Growth was slightly slower (5.8 per cent through the year) in the March quarter, but is expected to strengthen over time, aided by consumer spending, infrastructure development and new government guarantees around bank stability. Indian GDP is forecast to grow by 7.3 per cent in 2019, rising to 7.7 per cent by 2021.

Table 2.1: Key world macroeconomic assumptions

Per cent	2018	2019[a]	2020[a]	2021[a]
Economic growth[b]				
Advanced economies	2.2	1.8	1.7	1.7
Australia	2.8	2.1	2.8	2.8
Eurozone	2.1	1.6	1.7	1.7
France	1.5	1.3	1.4	1.5
Germany	1.5	0.8	1.4	1.5
Japan	0.8	1.0	0.5	0.5
New Zealand	3.0	2.5	2.9	2.8
South Korea	2.7	2.6	2.8	2.9
United Kingdom	1.4	1.2	1.4	1.5
United States	2.9	2.3	1.9	1.8
Emerging economies	4.5	4.4	4.8	4.9
ASEAN-5[d]	5.2	5.1	5.2	5.2
China[e]	6.6	6.3	6.1	6.0
Chinese Taipei	2.6	2.5	2.5	2.4
Emerging Asia	6.5	6.3	6.4	6.3
India	7.1	7.3	7.5	7.7
Latin America	1.0	1.4	2.4	2.6
Middle East	1.4	1.3	3.2	2.8
World[c]	3.6	3.3	3.6	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	0.72	0.75
Inflation rate				
United States	2.5	2.3	2.3	2.2
	2017–18	**2018–19**	**2019–20**	**2020–21**
Australia	1.9	2.0	2.4	2.5

Notes: The inflation rate for Australia is used to convert Australian export values to real 2018–19 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