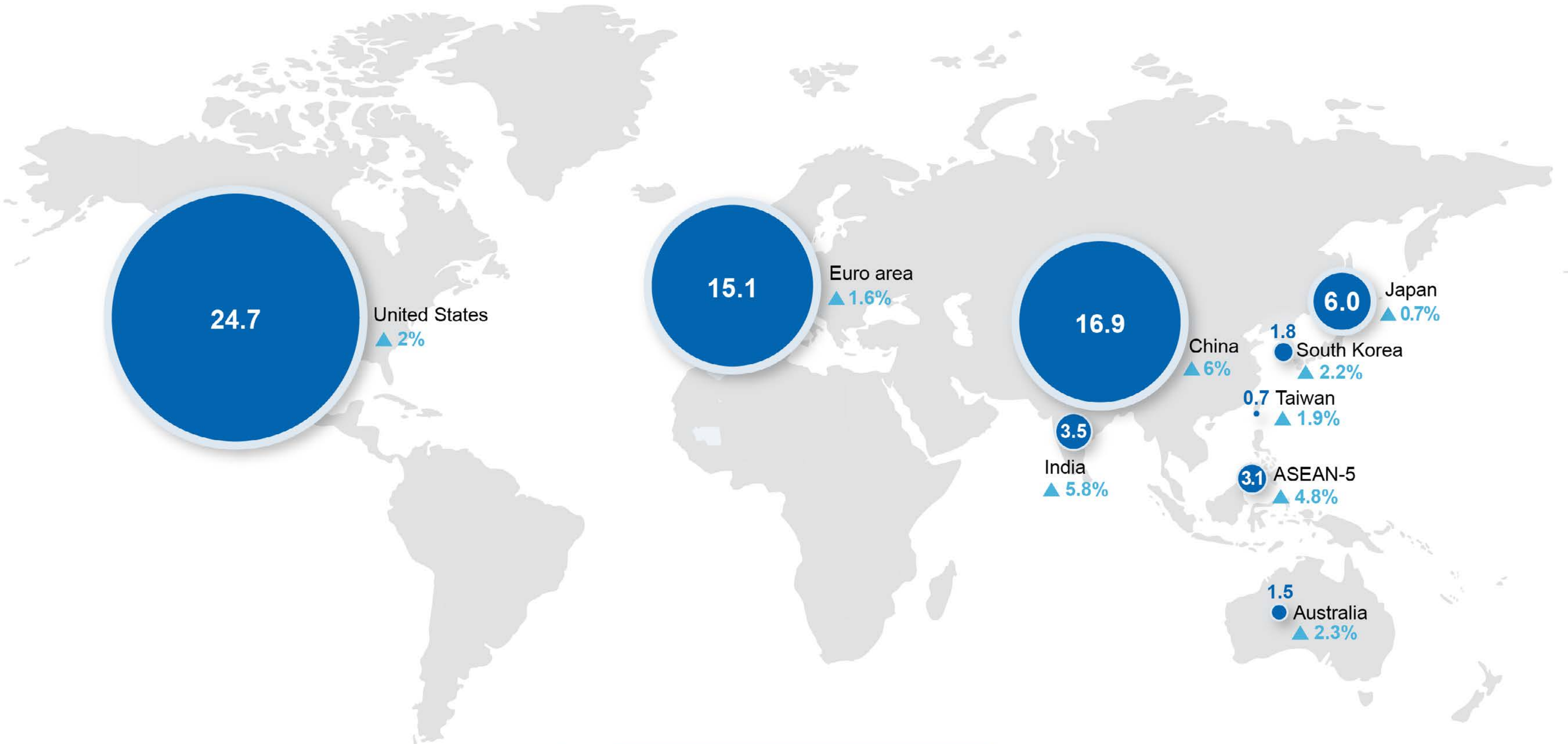
Macroeconomic Outlook



Global growth remains subdued. The global economy is forecast to grow by 2.9% in 2019, 3.3% in 2020 and 3.4% in 2021. Growth is expected to slowly recover over the outlook period, reaching 3.6% in 2025.

Risks — Trade tensions between the US and its trading partners, global spread of COVID-19, Brexit uncertainty.

= Share of global GDP

= Economic growth 2020*

2.1 Summary

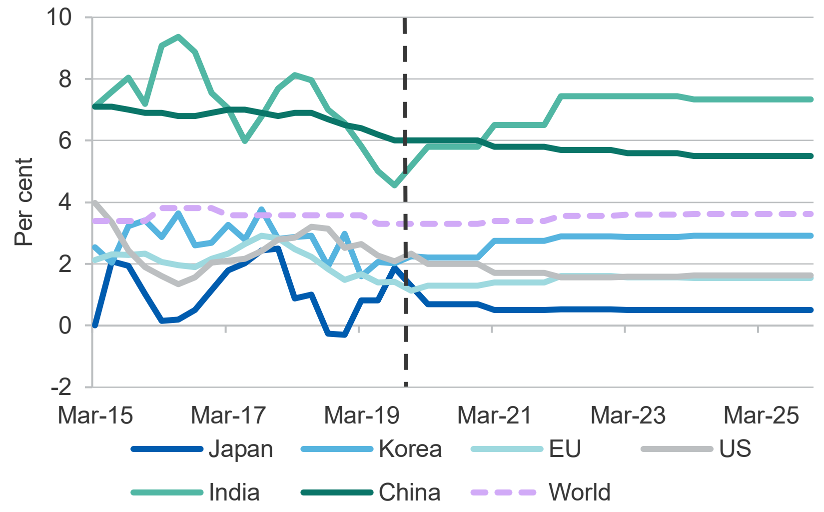
- The IMF forecasts world GDP growth will slowly recover over the outlook period, due to improving performances in developing economies. However, the IMF has suggested that 2020 growth will be revised down due to the impact of the COVID-19 outbreak.
- Stimulatory monetary policy is pushing down global bond yields and supporting consumer spending. With global inflation low, monetary conditions are likely to be supportive of growth over the medium term.
- The Phase One trade deal between the US and China offers some prospects for reducing trade tensions over time, though these tensions remain a notable risk to world GDP growth and commodity demand.

Global economic outlook

Over the outlook period, world economic growth is expected to recover from low levels recorded in 2019. The IMF estimates that world growth was 2.9 per cent in 2019 — the lowest rate since the global financial crisis in 2009. Growth is forecast to recover to 3.3 per cent in 2020, with further marginal increases over the rest of the outlook period. The IMF forecasts global GDP will rise by 3.4 per cent in 2021 and 3.5 per cent by 2025. These projected values are still below the long-term average growth rate of 3.8 per cent recorded between 2000 and 2018.

The IMF expects growth in advanced economies to fall from 1.7 per cent in 2019 to 1.6 per cent in 2020, remaining around these levels out to 2025. While there is significant uncertainty over Chinese growth in 2020 due to the COVID-19 outbreak (Box 2.1), growth in emerging markets and developing economies is forecast to rise from 3.7 per cent in 2019 to 4.4 per cent in 2020, and to 4.6 per cent in 2021. Some countries currently affected by domestic macroeconomic issues — including Argentina, India and Turkey — are expected to see a recovery in growth over 2020. An assumed easing in trade tensions is also expected to drive a recovery in developing Asia, with overall growth improving from 2022 (Figure 2.1).

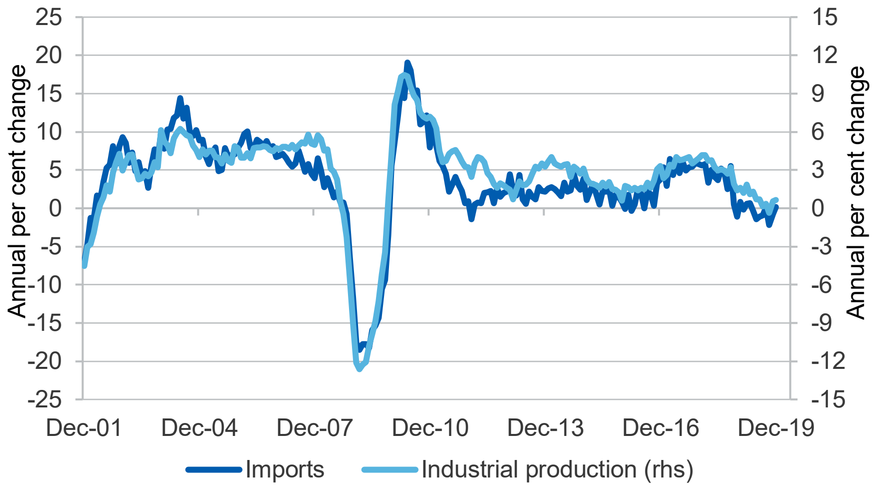
Figure 2.1: Annual growth in global GDP



Sources: Bloomberg (2020), IMF (2020)

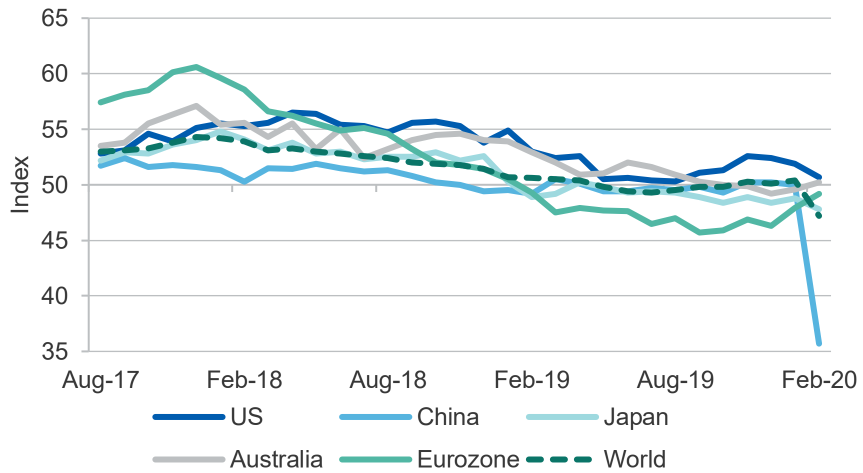
Easing US-China trade tensions are expected to contribute to a pick-up in global industrial production growth over coming months (Figure 2.2). The global Purchasing Managers Index (PMI) moved above 50 in January 2020— indicating expansionary conditions (Figure 2.3). This improvement has been temporarily disrupted by the COVID-19 outbreak, and the resulting impacts are assumed to persist over the first half of 2020 (see Box 2.1). COVID-19 has had a notable impact on industrial production in China, with the Chinese manufacturing PMI falling from 50 in January to 35.7 in February. World industrial production is expected to be constrained for the first half of 2020 due to the importance of China in international supply chains, and the global spread of the virus. The Chinese government is expected to embark on measures to cushion the impact of the COVID-19 outbreak, with industrial production growth expected to receive a boost as a result. Assuming the economic impacts of the COVID-19 outbreak ease in the second half of 2020, global industrial production growth is expected to return to pre-2019 levels.

Figure 2.2: World industrial production and imports



Sources: CPB Netherlands Bureau for Economic Policy Analysis (2020)

Figure 2.3: World industrial production and manufacturing Purchasing Managers' Indices



Source: Bloomberg (2020)

The UN projects that the world's population will grow by 0.5 billion between 2019 and 2025, with growth concentrated in urban areas. This urbanisation would usually be associated with rapid industrialisation. However, a high proportion of population growth is expected to occur in Sub-Saharan Africa, where the historical linkages between urbanisation and industrialisation are lower than in other regions. As a result, medium-term global industrial production growth is likely to be less influenced by population growth drivers over the outlook period.

Global trade fell in 2019, as a result of trade tensions between several major economies. Trade was notably lower for key manufacturing economies including China, the EU and Japan. Over the medium term, trade tensions are expected to ease, as China and the US continue bilateral negotiations (see Box 2.2) and the UK leaves the EU. If trade barriers are wound back and business confidence improves, global trade can be expected to return towards trend growth.

Slowing industrialisation in parts of the world is likely to slightly reduce the demand growth for cement, coal, steel, and associated materials over the outlook period. However, technological change and a need for less polluting energy sources are driving growth in other areas including minerals used in 'high tech' applications: copper, nickel and rare earths.

China

Chinese economic growth fell to 6.1 per cent in 2019 — the lowest rate in 29 years. Lower growth rates were driven by US-China trade tensions and slowing Chinese consumer demand. The IMF is forecasting that Chinese growth will continue trending downward, falling to 6.0 per cent in 2020. However, this reflects structurally slowing Chinese growth rather than impacts of the trade tensions that affected the Chinese economy in 2018 and 2019. The IMF revised Chinese growth estimates upwards by 0.2 percentage points for 2020 following the announcement of the Phase One trade deal between China and the US. The impact of COVID-19 on the Chinese economy remains uncertain, with the IMF suggesting on 22 February 2020 that COVID-19 would decrease 2020 Chinese growth by

0.4 percentage points from their baseline forecasts, with world growth being 0.1 percentage points lower.

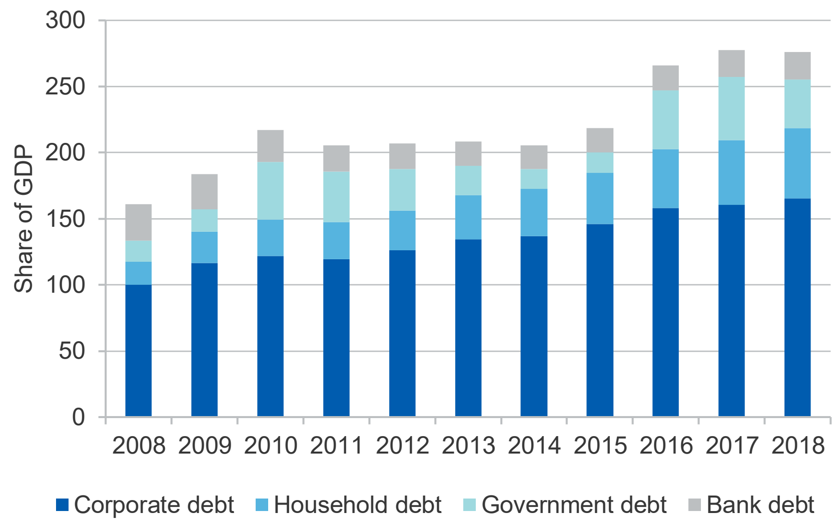
To offset the impacts of COVID-19 and, more generally, to prevent a further decline from the current 29-year growth low, the Chinese government implemented a range of fiscal and monetary stimulus policies in late 2019 and early 2020. In February 2020, the People's Bank of China announced plans to inject US$173 billion into the money supply to increase liquidity and offset some of the economic impacts of the COVID-19 outbreak on consumer spending.

China has recently faced significant inflationary pressures as a result of an outbreak of African Swine Fever in the country's pig population. With pig meat being the most consumed meat in China, the slaughter of hundreds of millions of diseased pigs has pushed meat prices sharply higher. As a result, the food price index rose by 17 per cent and the consumer price index by 4.5 per cent. COVID-19 is also driving inflationary pressures, with stockpiling and transport restrictions raising prices for consumer goods. This may increase the concerns of the Chinese central bank in adopting more expansionary monetary policies over the medium term.

Over the medium term, the Chinese government is expected to continue targeting economic growth, poverty reduction and addressing pollution. These policies will influence China's energy consumption and the level of industrial production, with mixed results for Australia's resource and energy exports.

Chinese economic growth is expected to continue trending slightly downward, falling to 5.5 per cent in 2025. Assumed actions to reign in debt levels (Figure 2.4) and reduce risks to the Chinese financial sector are expected to increase economic stability, somewhat at the expense of economic growth.

Figure 2.4: Share of Chinese debt to GDP



Source: Bloomberg (2020)

Box 2.1: COVID-19

On 31 December 2019, China reported the COVID-19 outbreak to the World Health Organisation (WHO). As at 9 March 2020 the WHO have reported 109,577 confirmed cases, with 80,904 in China and 28,673 outside of China. While the majority of COVID-19 cases have been reported from mainland China, a significant number of cases are now being reported outside of mainland China including in Iran, Italy, Japan, and South Korea. In response to the outbreak, the Chinese Government put in place a number of measures (including travel restrictions, delayed return to work for many; and non-essential industries remaining closed) to limit the outbreak, which generated substantial disruption within China.

Some Australian businesses whose operations have direct links with China have been immediately exposed. Some export-focused sectors are experiencing a reduction or cancellation of orders by Chinese buyers, along with other business disruptions in China including to shipping movements and manufacturing capacity.

Businesses that have operations in China and/or rely on Chinese inputs for their goods and services are experiencing supply chain disruptions. The COVID-19 outbreak could result in further falls in commodity prices within China, with potentially significant implications given resources and energy exports accounted for $103 billion of Australia's $153 billion of exports to China in 2018–19.

While the medium and longer term impacts remain unclear, at the time of writing, oil prices had fallen by more than 20 percent since January 2020. This fall will drive commensurate falls in oil price-linked LNG contract prices. Commodity prices could swing sharply over the first half of 2020, reflecting the impact of the slow return to work in China's resource-intensive industries and the potential for an offsetting influence from further Chinese stimulatory measures. Gold, however, is the notable exception, benefitting from a flight to safety by investors. In addition, the Australian dollar has declined as a result of these commodity price falls, partly cushioning the impact of the outbreak on the Australian economy.

World economic growth is likely to fall as a result of COVID-19, with the outbreak having a global effect on consumption patterns, supply chains and travel. On 22 February 2020, the IMF suggested that COVID-19 would reduce their forecasts for Chinese economic growth by 0.4 percentage points, and world economic growth by 0.1 percentage points. These forecasts are likely to be revised in the next IMF World Economic Outlook, which is expected in April.

The OECD has also revised their forecasts in response to COVID-19. Economic growth in China has been revised down 0.8 percentage points in the latest forecast, and world growth has been revised down 0.5 percentage points. The OECD has also forecast significant impacts on several other economies (Table 2.1).

Table 2.1: OECD economic growth projections

Economy	Interim 2020 growth projections	Change from previous release
World	2.4	-0.5
Australia	1.8	-0.5
Euro Area	1.2	-0.3
Japan	0.2	-0.4
Korea	2.0	-0.3
China	4.9	-0.8
India	5.1	-1.1

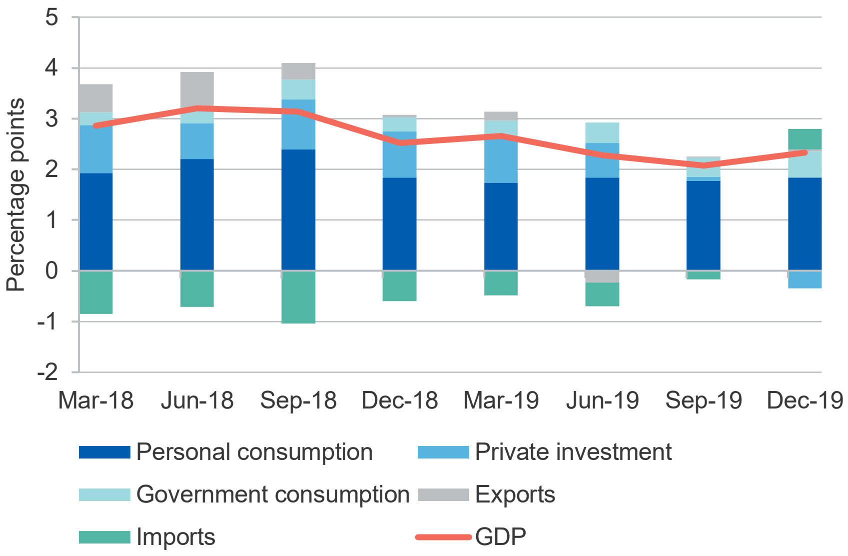
Source: OECD (2020)

United States

US economic growth slowed to 2.1 per cent in 2019, as trade tensions negatively affected business spending and investment. This has been partially offset by strong household and government spending, and the impact of solid growth in employment (Figure 2.4).

To head off a potential slowdown in the US economy, the US Federal Reserve cut rates three times in 2019. Economic growth stabilised in late 2019, with key economic indicators improving. These improvements were short lived, and the impacts of COVID-19 resulted in the US Federal Reserve cutting rates by a further 50 basis points on 3 March 2020. This cut came out-of-cycle, and is the first time such a cut has occurred since 2008. Further cuts are possible if COVID-19 continues to weigh on US economic growth. Interest rates are expected to rise modestly over the medium term. Rate increases could be constrained by high household debt, which is likely to amplify the impacts of interest rate rises on consumer spending.

Figure 2.5: Contributions towards US GDP growth



Source: Bloomberg (2020)

US policy priorities and levels of government spending over the outlook period are less certain as the 2020 US general elections approach.

Despite the recent Phase One deal between China and the US, trade tensions have the potential to reduce US economic activity over the outlook period. Ongoing issues include potential tariffs on EU automobile imports, the January 2020 US tariff increases on aluminium and steel imports from numerous major producers, and US sanctions on Iran and Venezuela.

US growth is forecast to slow to 2.0 per cent in 2020 and decline further to 1.7 per cent in 2021. Growth is projected to stabilise at 1.6 per cent between 2022 and 2025. Slowing economic growth is expected largely due to falling consumption and employment growth.

Box 2.2: US-China Phase One trade deal impact on energy markets

On 15 January 2020, China and the US signed a Phase One trade deal which reduced some US tariffs on Chinese goods in exchange for Chinese pledges to purchase more American products. As part of the deal, China agreed to purchase an additional US$200 billion of US goods and services in 2020 and 2021, relative to 2017 levels. Of this amount, US$52 billion is to be met through imports of energy products — including LNG, crude oil (including refined products), and coal (including metallurgical coal). The extent of increases in Chinese imports of US energy products remains unclear, as does the subsequent impact on global trade flows. US supply constraints may also limit any increases in Chinese purchases of US energy products. Crude oil and LNG are expected to account for the majority of higher US energy exports to China, with potential negative flow-on implications to some of Australia's resource and energy exports.

The extent that Chinese imports of US of energy products increase is also complicated by impacts of the COVID-19 outbreak. At the time of writing, the outbreak has significantly reduced Chinese LNG and oil demand. This will likely reduce Chinese purchases of US energy products, although trade flows could still be diverted if Chinese purchasers were to prioritise purchasing US commodities.

US oil exports to China could increase significantly under the Phase One trade deal. Between 2017 and 2019, US total oil exports rose dramatically, but exports to China were constrained by trade tensions. Phase One purchase targets may offset this constraint, though export growth could still be contingent on further investments to refine more US oil, and expected minimal 2020 Chinese oil consumption growth as a result of COVID-19. The largest impacts to Australia are likely to be through higher competition for imports of US oil, since the US is now the second largest source of Australian crude oil and refinery feedstock imports.

China may also choose to import greater amounts of US LNG, posing risks to Australian LNG export earnings. Impacts on Australia are likely to be somewhat tempered, since around 70 per cent of Australian LNG exports to China are on long-term contracts. On 17 February 2020, the Chinese government allowed firms to apply for exemptions from tariffs on various US products, including LNG. This increases the competitiveness of US LNG against other sources including the 30 per cent of Australian LNG exports to China sold on spot markets (see Box 7.1).

US thermal coal exports to China are unlikely to increase notably. US coal is relatively high cost, which is a barrier to bilateral trade growth.

The Phase One deal could offer limited upsides to Australian exports, notably for commodities where Australia is not in competition with the US. The IMF is forecasting that the Phase One deal will increase world economic growth slightly in 2020. China is Australia's largest export market for Australian commodities, while the US is an important consumption market for products using Australian commodities. As a result, Australia would likely benefit from any lowering in trade tensions.

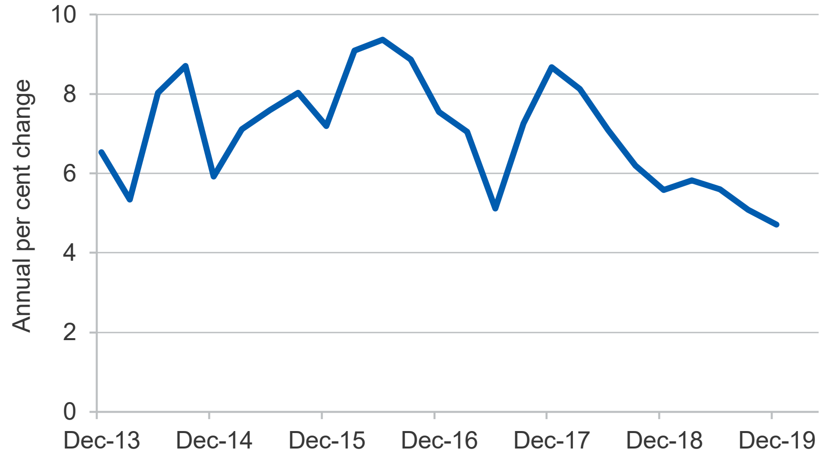
India

Indian economic growth slowed to an annualised 4.7 per cent in the December quarter, the lowest value recorded in over six years (Figure 2.6). Growth has been affected by ongoing weakness in the financial sector, as a result of financially stressed Indian nonbank finance companies (NBFCs). Financial sector weakness also appears to be materially affecting household consumption.

In response to slowing economic growth and financial sector stress, the Reserve Bank of India cut interest rates five times in consecutive meetings during 2019. The Reserve Bank of India is likely to consider further rate cuts in 2020. However, this will be complicated by consumer inflation being above the central bank's target band, driven by soaring food prices.

The Indian government's 2020–21 budget included moderate fiscal stimulus measures, mostly tax cuts. However, ongoing government intentions to rein in the fiscal deficit reduce the likelihood of the Indian government introducing large scale fiscal stimulus packages over the medium term.

Figure 2.6: Indian quarterly GDP growth



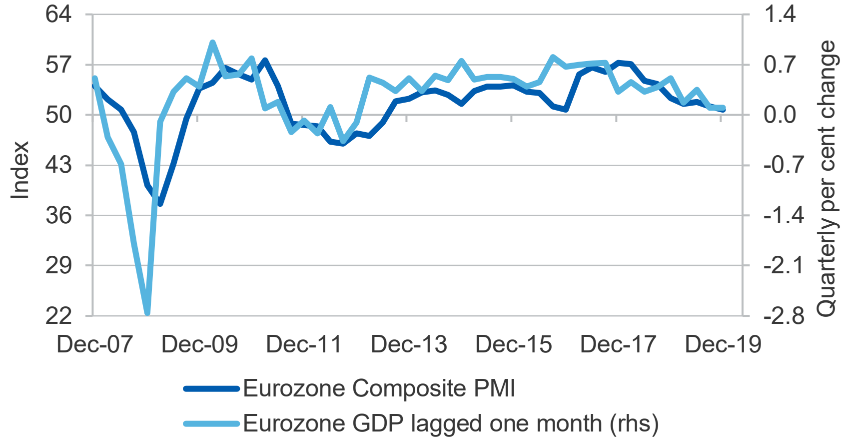
Source: Bloomberg (2020)

As a result of lower interest rates and the assumed passing of liquidity pressures on NBFCs, the IMF is forecasting that Indian economic growth will marginally recover to 5.8 per cent in 2020. Growth is forecast to increase further to 6.5 per cent between 2021 and 2025. These values are marginally lower than the 2018 growth rate of 6.8 per cent.

Europe

Eurozone GDP growth slowed to 1.2 per cent in 2019, with growth in the December quarter falling to 0.1 per cent (on a quarterly annualised basis). Growth in the December quarter was minimal in France and Italy, and fell in Germany, with industrial production negatively affected by Brexit uncertainty and global trade tensions. However, there are signs that conditions in the region are improving, with the EU Composite PMI recently stabilising (Figure 2.7), indicating that the outlook for the EU manufacturing sector is beginning to turn. Remaining risks include the threat of US tariffs on imports of EU cars, as the automotive sector is a significant contributor to the EU economy, and the US the number one destination for EU automotive exports.

Figure 2.7: Eurozone composite PMI and GDP



Source: Bloomberg (2020)

On 31 January 2020, the UK formally left the EU, and a trade agreement between the two economies is being negotiated. These negotiations will have implications for EU and UK growth over the medium term, and ongoing negotiations are likely to affect investment and consumption in the next year or two. The UK and the EU are also negotiating separate trade deals with the US, a major export market for both economies. Ratified agreements would deepen economic linkages between the economies, and likely increase economic growth.

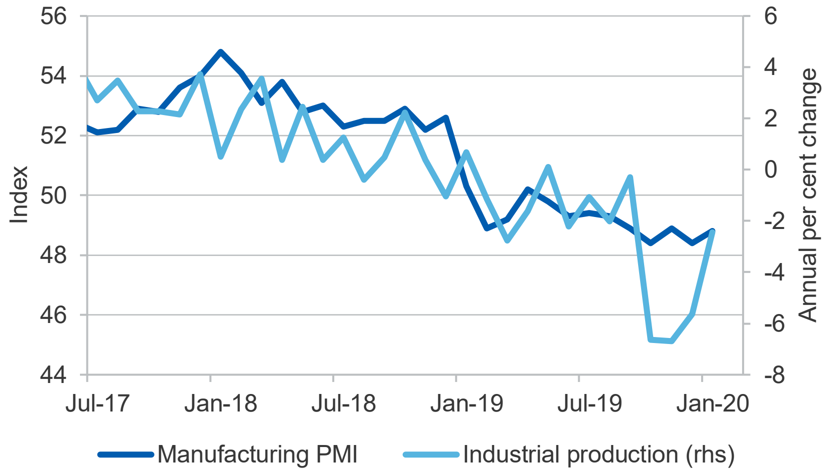
In November 2019, the European Central Bank re-commenced a quantitative easing program, purchasing €20 billion of bonds a month. The central bank also reduced the deposit rate to -0.5 per cent — the lowest on record. This expansionary monetary policy is expected to continue over the short term, due to expected low EU growth rates and minimal opportunity for fiscal stimulus due to high debt levels.

The IMF expects EU economic growth to rise slowly, reaching 1.3 per cent in 2020, 1.4 per cent in 2021, and 1.5 per cent by 2025.

Japan

Japanese economic growth in 2019 was estimated to be 1.0 per cent. This represented a three-fold increase over the previous year, reflecting improved household consumption and impacts of the Japanese government's fiscal stimulus packages. Consumption growth is expected to be more subdued over the medium term, with the October 2019 rise in the national sales tax expected to weigh on household consumption, particularly early in 2020. Partially offsetting this should be the stimulatory impacts of the Tokyo 2020 Olympic Games, and planned infrastructure investment beyond the Olympic Games — part of the Japanese government's recently announced US$120 billion stimulus package.

Figure 2.8: Japanese Industrial production and manufacturing PMI



Source: Markit (2020)

The Japanese composite PMI increased in January 2020, suggesting expansion across key industries. This rise was largely driven by the Japanese services industry, with Japanese households slowly adjusting to the October 2019 hike in sales taxes. Outcomes for the manufacturing sector were more subdued, with the index continuing to suggest contractionary conditions. The spread of COVID-19 through Japan resulted in a PMI values falling in February (Figure 2.8), with the impacts amplified by the disease spreading throughout Japan and the deep economic ties between China and Japan.

Japanese growth in 2020 is forecast to fall to 0.7 per cent, as a result of lower household consumption growth. Growth is forecast to decline to 0.5 per cent in 2021, stabilising at this level out to 2025. Economic growth in Japan will be constrained for the foreseeable future by the nation’s declining population and aging workforce.

South Korea

In 2019, South Korean economic growth fell to 1.9 per cent, as global trade tensions weighed on South Korean exports. Growth recovered partially in the December quarter as a result of higher government infrastructure spending. The Bank of Korea reduced rates twice in 2019, taking the official interest rate to a record low 1.25 per cent. These expansionary policies are expected to support growth in 2020, though strong growth is likely to be contingent on export demand and a recovery from COVID-19.

There are signs that South Korean exports are beginning to increase, particularly for semi-conductors, which accounted for 21 per cent of South Korean exports in 2018. However, exports will continue to be affected by trade tensions, including between Japan and South Korea. Tensions arose between South Korea and Japan in July 2019, 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. Recent developments indicate trade tensions are easing, with the South Korean government suspending its WTO case against Japan, and Japan removing restrictions on one of the three targeted chemicals. The outcome of ongoing negotiations is likely to have a significant influence on medium term economic growth in both South Korea and Japan.

The IMF expects South Korean growth to recover to 2.2 per cent in 2020, as a result of ongoing impacts of government stimulus and a gradual improvement in global economic activity. Over the medium term, growth is expected to increase further as trade tensions recede and higher global demand supports the export-oriented South Korean economy.

ASEAN

Growth in the ASEAN-5 economies (Indonesia, Malaysia, the Philippines, Singapore and Thailand) is estimated by the IMF to be 4.8 per cent in 2019. Global trade tensions have weighed on the export-oriented region, particularly in Indonesia and Thailand. Furthermore, Malaysian economic growth has been affected by trade tensions with India, which has imposed restrictions on imported Malaysian palm oil.

Industrialisation is expected to be a key driver of ASEAN growth. In response to US tariffs on imports of Chinese goods, a number of companies have reportedly shifted supply chains into other parts of developing Asia, particularly Cambodia and Vietnam.

ASEAN-5 growth is forecast by the IMF to increase marginally to 4.8 per cent in 2020, and to 5.3 per cent by 2025. Growth in 2020 may be negatively affected by COVID-19 due to the presence of China in regional supply chains, and the virus spreading further throughout South East Asia.

Table 2.2: Key world macroeconomic assumptions

Per cent	2019	2020[a]	2021[a]	2022[a]	2023[a]	2024[a]	2025[a]
Economic growth[b]							
Advanced economies	1.7	1.6	1.6	1.6	1.5	1.6	1.6
United States	2.4	2.0	1.7	1.6	1.6	1.6	1.6
Japan	0.9	0.7	0.5	0.5	0.5	0.5	0.5
European Union 28	1.5	1.3	1.4	1.6	1.6	1.5	1.5
Germany	0.5	1.3	1.4	1.3	1.2	1.2	1.2
France	1.2	1.1	1.4	1.4	1.4	1.4	1.4
United Kingdom	1.2	1.3	1.3	1.5	1.5	1.5	1.5
South Korea	2.0	2.2	2.7	2.9	2.9	2.9	2.9
New Zealand	2.5	2.7	2.6	2.6	2.5	2.5	2.5
Emerging economies	3.9	4.4	4.6	4.8	4.8	4.8	4.8
Emerging Asia	5.9	5.8	5.9	6.1	6.0	6.0	6.0
South East Asia[d]	4.8	4.8	5.1	5.2	5.3	5.3	5.3
China[e]	6.1	6.0	5.8	5.7	5.6	5.5	5.5
Chinese Taipei	2.0	1.9	2.1	2.1	2.1	2.0	2.0
India	6.1	5.8	6.5	7.4	7.4	7.3	7.3
Latin America	0.2	1.6	2.3	2.6	2.8	2.7	2.7
Middle East	1.3	3.2	2.8	2.8	2.8	2.9	2.9
World[c]	3.0	3.3	3.4	3.6	3.6	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: Bloomberg (2020); Department of Industry, Science, Energy and Resources (2020): IMF (2020)

Table 2.3: Exchange rate and inflation assumptions

	2019	2020[a]	2021[a]	2022[a]	2023[a]	2024[a]	2025[a]
AUD/USD exchange rate	0.70	0.69	0.72	0.72	0.72	0.72	0.72
Inflation rate							
United States	1.8	2.1	2.1	2.3	2.3	2.3	2.3
	2018–19[a]	**2019–20[a]**	**2020–21[a]**	**2021–22[a]**	**2022–23[a]**	**2023–24[a]**	**2024–25[a]**
Australia	1.9	2.0	2.4	2.5	2.5	2.5	2.5

Notes: **a** Assumption; 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.

Sources: Department of Industry, Science, Energy and Resources (2020); Bloomberg (2020) Survey of economic forecasters