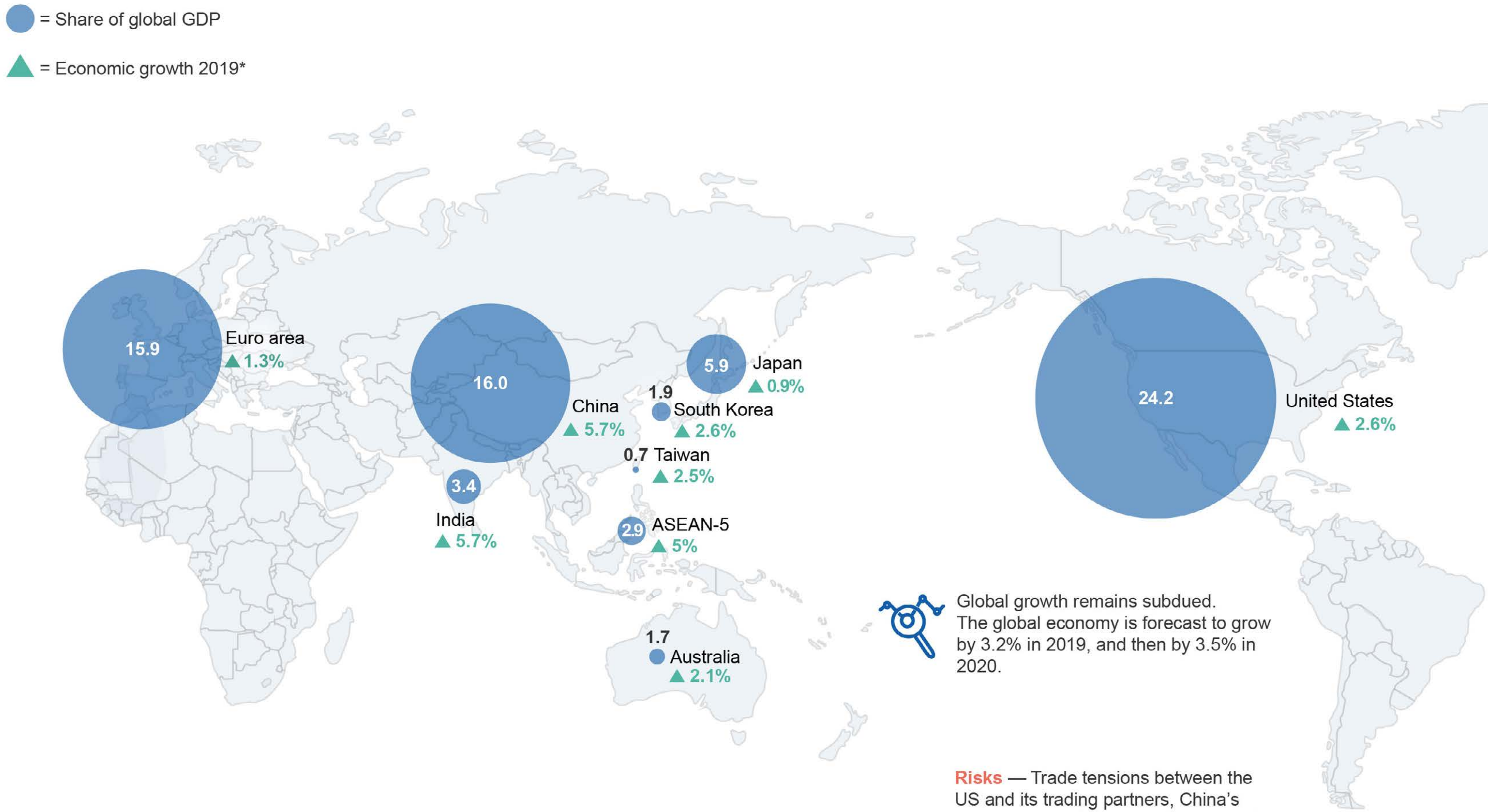
Macroeconomic Outlook

Resources and Energy Quarterly September 2019



Global growth remains subdued. The global economy is forecast to grow by 3.2% in 2019, and then by 3.5% in 2020.

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

- The IMF is forecasting world economic growth of 3.2 per cent in 2019, 3.5 per cent in 2020 and 3.6 per cent in 2021.
- World trade and industrial production forecasts have weakened, due to the US-China trade frictions. Targeted stimulus measures are being implemented in China, in an attempt to offset the economic impacts of the US trade measures.

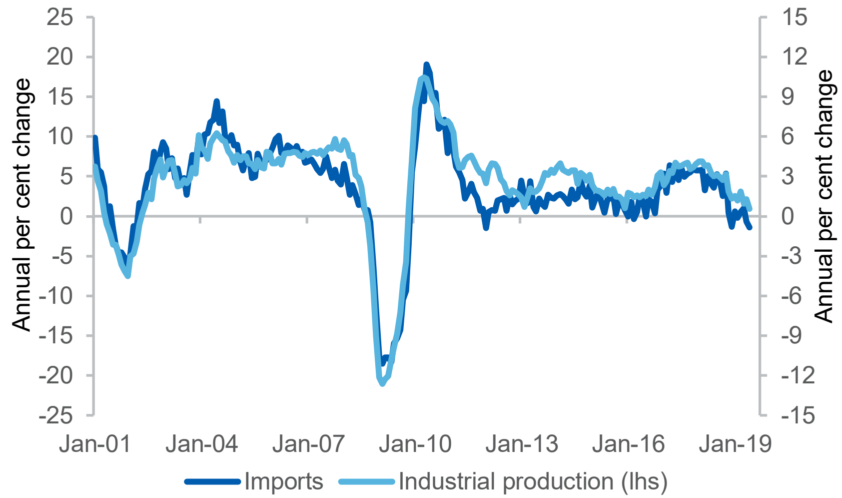
2.2 Global economy

The global economy has slowed again in the past quarter, and forward indicators point to a further slowdown in the December quarter. Some central banks are easing monetary policy, or are delaying a tightening of (already) easy monetary policy, in an attempt to sustain growth at a reasonable pace. The escalation of US-China trade tensions presents the most significant risk to the global outlook, and ongoing uncertainty over Brexit is likely to continue to impact on economic activity in Western Europe.

Global trade has declined noticeably in 2019 (Figure 2.1). The Chinese economy has slowed, and lower Chinese imports have affected export activity in many nations. Global supply chains are being adjusted, as the 10 per cent tariff on US$200 billion of US imports of Chinese goods — first imposed in May — is raised to 25 per cent. (China recently responded with higher tariffs on US$75 billion of imported US goods. An increase in the existing tariff to 30 per cent was then announced by the US Administration. The US also announced, but then partially delayed, a 15 per cent tariff on the final US$300 billion of imports from China that were untaxed.) Businesses are now delaying investment, due to growing uncertainty in trade and foreign investment. There is now a risk that households will start to delay purchases too.

While it is probable that world GDP growth will slow only modestly relative to the expected slowing in industrial production growth (Figure 2.2), the demand for resource and energy commodities is more closely related to world industrial production growth than world GDP growth.

Figure 2.1: World trade vs world industrial production



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

Figure 2.2: Global GDP and industrial production growth

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

After a particularly buoyant twelve months from mid 2017 to mid 2018, trade tensions and a global slowdown have taken a toll on the global manufacturing Purchasing Managers Index (PMI), which fell to 49.5 in August (Figure 2.3). The index points to a further slowing in industrial production growth — and possibly even a contraction on an annualised basis — in the coming few months.

Figure 2.3: World Manufacturing PMI vs World Industrial Production

Source: CPB (2019), IHS Markit and JP Morgan (2019)

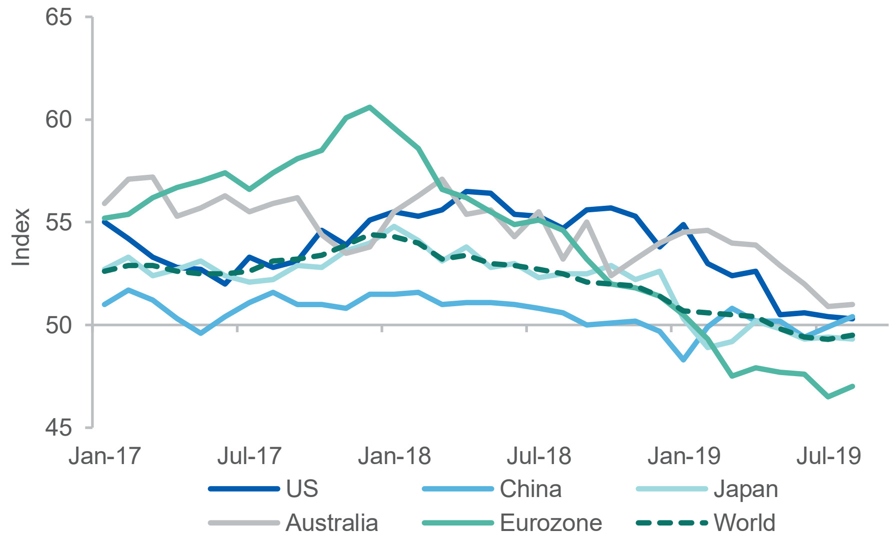
The ongoing US-China trade friction is likely to lead to a limited, highly targeted series of economic stimulus measures in China, as Beijing attempts to achieve its growth target of 6.0-6.5 per cent. Infrastructure projects, increased liquidity in the financial system and measures to increase consumer spending are expected to be the focus of the Chinese government's policy changes.

The government is unlikely to include the property sector among sectors to receive large stimulus: over-building and existing high debt levels could expose banks and local governments disproportionately to any downturn.

With the US-China trade friction drawing out, some manufacturers in China have recently moved production to other countries, including Vietnam and Cambodia, in order to avoid US tariffs.

Of the manufacturing indices, the Eurozone PMI has fallen the most (Figure 2.4). Key economies, such as Germany, have been hit by both Brexit concerns and slowing Chinese demand. Consumer sentiment in middle/high income Chinese households has been impacted by the US-China trade tensions.

Figure 2.4: Manufacturing PMIs



Source: IHS Markit (2019)

Geopolitical problems are also adding to risks to the world economic outlook. Tensions in the Strait of Hormuz, Hong Kong and the ongoing conflict in Syria, are among the more notable of these. But diplomatic tensions between Japan and South Korea, and between India and Pakistan, also have the potential to lower business and consumer confidence over the coming year.

2.3 Country and regional economic conditions

The US economy has slowed modestly so far in 2019

Growth in the US economy has slowed in recent months, as the impact of the 2018 tax cuts largely disappears, and trade tensions impact on business spending. The US Federal Reserve has cut the federal funds rate in response to the slowdown, and in an attempt to head off a further decline in GDP growth. Long term US bond yields have fallen sharply, reducing home loan interest rates and supporting household spending.

The US Institute of Supply Management (Manufacturing) Index hit a 43-month low in August 2019 and moved below the 50 mark (suggesting contractionary conditions). The new and/or increased tariffs announced by the US Administration since the June 2019 *Resources and Energy Quarterly* are likely to see the index fall further. Consumer confidence fell sharply in August and, after a decade of trend decline, initial jobless claims have recently levelled out (Figure 2.5). This, and the heightened trade tensions with China, point to a near term levelling out in the US unemployment rate, with the economy likely at, or close to, full employment anyway.

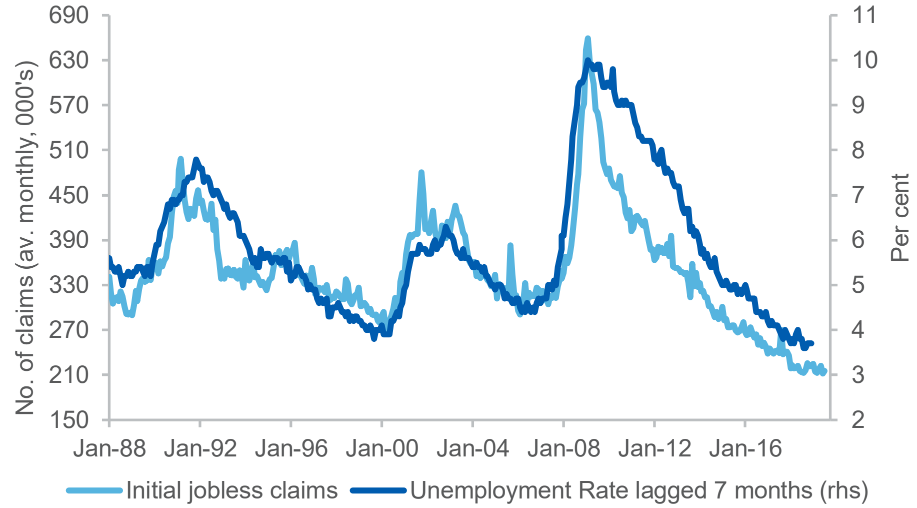
US economic growth is projected to moderate over the outlook period, falling to 2.6 per cent in 2019 and around 1.9 per cent in 2020 and 2021.

US tariffs have had a noticeable adverse impact on the Chinese economy

China's GDP growth slowed to 6.2 per cent in the June quarter, the slowest growth in decades. Chinese industrial production growth has also declined to multi-decade lows, at 4.4 per cent in August. Vehicle sales have fallen noticeably, after years of strong growth (Figure 2.6). Only some of the decline in car sales in China is due to lower government incentives.

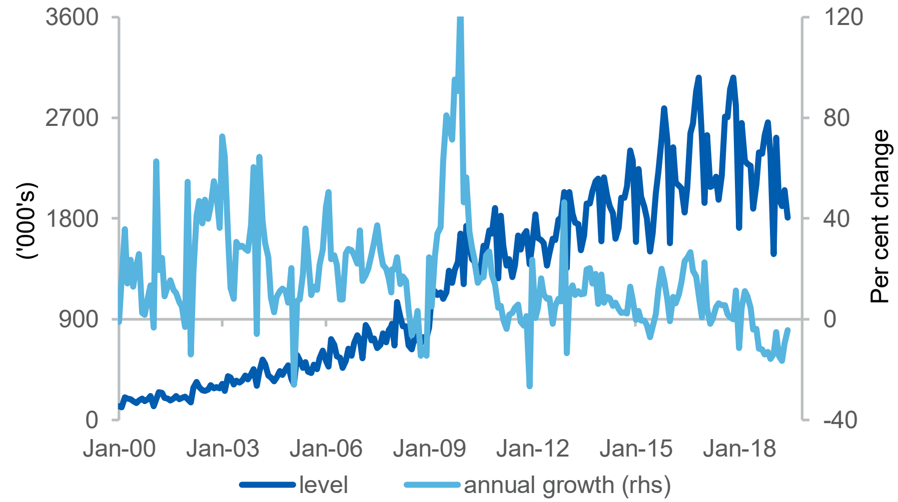
China's Manufacturing PMI, a forward indicator of activity in the manufacturing sector, suggests that activity is set to decline further in the December quarter. Chinese property markets (Figure 2.7) now appear to be cooling, after easing measures in some cities boosted activity in late 2018 and early 2019.

Figure 2.5: US unemployment rate and initial jobless claims, monthly



Source: US Bureau of Labor Statistics (2019)

Figure 2.6: Chinese vehicle sales



Source: Bloomberg (2019)

Any sustained downturn in the Chinese property market would likely have implications for new dwelling construction and motor vehicle purchases, both industries of which use large amounts of steel. Beijing is unlikely to try to maintain economic growth via measures to boost the property sector, seen by some as oversupplied.

Motor car purchases will likely be impacted by the wealth effect: a fall in property values typically discourages consumers from making big ticket purchases.

Figure 2.7: Chinese property indicators

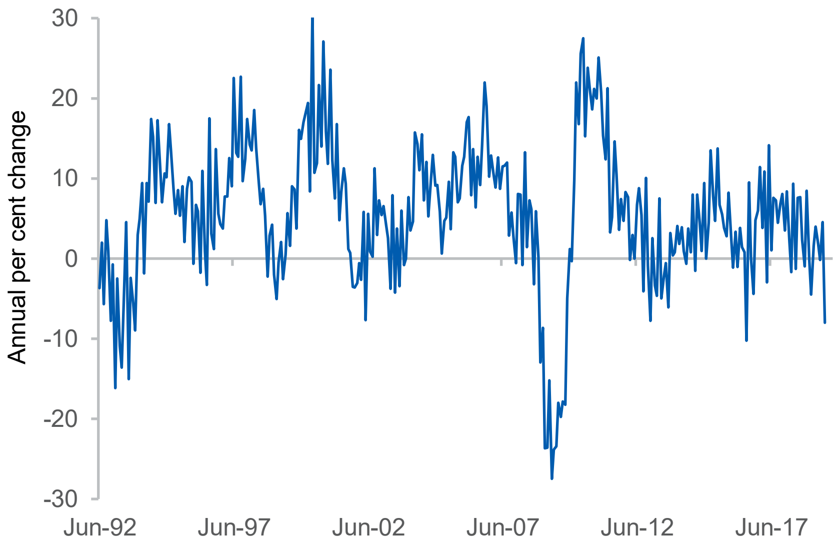
Source: Bloomberg (2019); National Bureau of Statistics of China (2019)

Chinese GDP growth is expected to continue easing slowly over the forecast period, averaging 5.5-6.0 per cent. The Chinese Government may choose to accept slower growth as an unavoidable result of the tariffs imposed on imports of Chinese goods by the US Administration.

Europe faces sluggish growth and rising risks

Eurozone growth has slowed from 2018 levels, led by a noticeable downturn in the German economy. Uncertainty over Brexit and slower exports to China and the US appear to be taking a toll on German exports (Figure 2.8). Leading indicators point to further weakening in the Eurozone, with the Composite PMI pointing to continuing sluggish GDP growth in the September quarter 2019.

Figure 2.8: German exports



Source: Bloomberg (2019)

Following the European Central Bank's (ECB's) policy meeting on 12 September, the bank cut its benchmark deposit rate by 10 basis points to -0.5 per cent, and pledged to reintroduce a quantitative easing program by buying 20 billion euros worth of bonds every month, indefinitely, starting in November. Many Eurozone nations have little/no scope to support growth by easing fiscal policy substantially. IMF forecasts for economic growth in the Eurozone have been revised down, to 1.3 per cent in 2019, and around 1.6 per cent in 2020 and 2021.

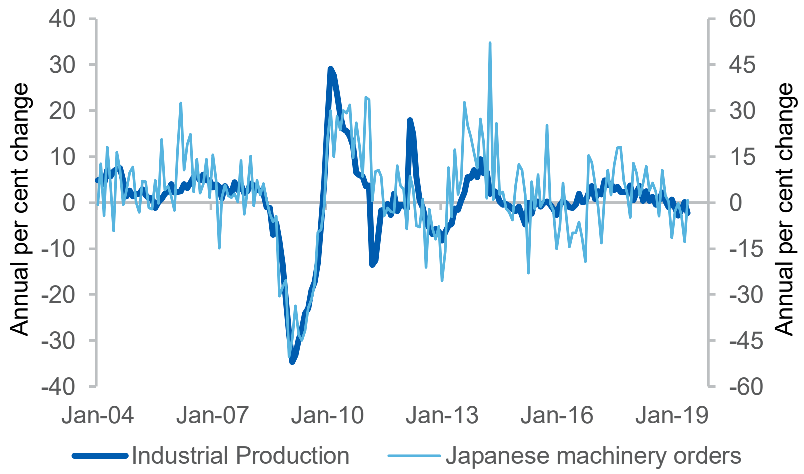
Japan's GDP growth is likely to ease over the outlook period

Japan's Tankan indices for large and small manufacturers have both weakened to their lowest level in almost three years. The declines come as external demand weakens in the face of slowing global growth and increased global trade friction. Japanese vehicle makers are being affected by lower Chinese demand. Machinery orders data point to an ongoing fall in Japanese industrial production in the coming few months (Figure 2.9).

An escalation of trade tensions between Japan and South Korea poses risks to the outlook. This escalation started in July, when Japan placed trade restrictions on three chemical materials widely used by South Korean companies that make semiconductors. Tensions has adversely impacted sectors such as tourism and consumer goods in both nations.

Japanese GDP growth is forecast to be 0.9 per cent in 2019. A US-Japan trade deal — expected at end September — would help to avoid a substantial fall in growth in 2020, which should also be supported by the hosting of the 2020 Olympic games.

Figure 2.9: Japanese industrial production vs machinery orders



Source: Bloomberg (2019)

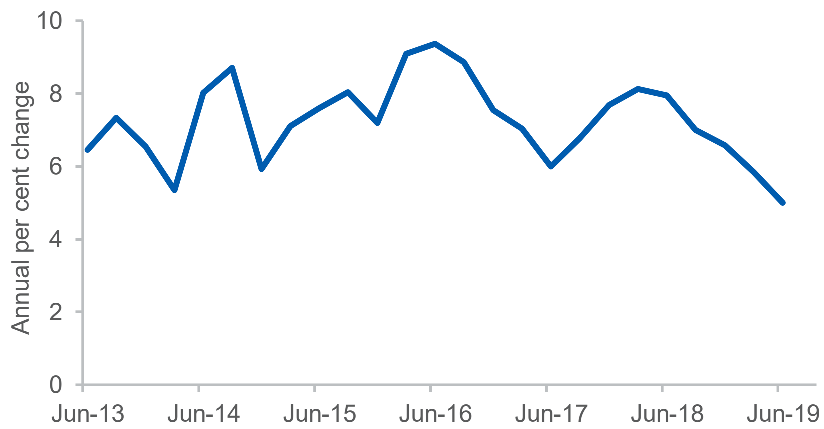
South Korea faces mild constraints as a result of trade tensions

South Korean economic growth has remained relatively weak in recent months, and is expected to be impacted by the tensions with Japan and the anticipated slowdown in China over the next few quarters. Economic growth is projected to be around 2.7 per cent in 2019 and 2020. A modest recovery — to 2.9 per cent — is likely in 2021, as the world is expected to recover from the US-China trade friction-related slowdown.

Indian growth has slowed

Growth in the Indian economy has stepped down a notch in 2019, hurt by weaker consumer confidence. Related to this decline in consumer confidence, motor vehicle sales have weakened noticeably. Indian shadow banks have encountered a liquidity crunch, following the collapse late last year of Infrastructure Leasing & Financial Services, a major nonbank finance company (NBFC) in India. That led to a surge in borrowing costs, forcing NBFCs to freeze, or tighten, lending practices. Indian GDP growth is expected to remain above 5.0 per cent in 2019, and to improve to 6.0 per cent in 2020 and 2021 — as financial conditions ease.

Figure 2.10: 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	2.2	1.9	1.7	1.7
Australia	2.8	2.1	2.8	2.8
Eurozone	1.9	1.3	1.6	1.7
France	1.7	1.3	1.4	1.5
Germany	1.4	0.7	1.7	1.5
Japan	0.8	0.9	0.4	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	1.3	1.4	1.5
United States	2.9	2.6	1.9	1.8
Emerging economies	4.5	4.1	4.7	4.9
ASEAN-5[d]	5.2	5.1	5.2	5.2
China[e]	6.6	5.7	5.5	6.0
Chinese Taipei	2.6	2.5	2.5	2.4
Emerging Asia	6.5	6.2	6.2	6.3
India	6.8	5.7	6.0	6.5
Latin America	1.0	0.6	2.3	2.6
Middle East	1.6	1.3	3.3	2.8
World[c]	3.6	3.2	3.5	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	0.75	0.70	0.72	0.74
Inflation rate				
United States	2.3	2.1	2.3	2.2
	2017–18	**2018–19**	**2019–20**	**2020–21**
Australia	1.9	1.6	2.1	2.4

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