



# US POLICY A KEY UNCERTAINTY FOR THE **GLOBAL GROWTH** **OUTLOOK**

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## ABOUT **THE AUTHOR**

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The global reflation trade continued to pick up steam at the start of the year, as a number of data releases all confirmed that the upturn in growth late last year has persisted into early 2017. Investors and analysts have since taken notice of the improving macroeconomic conditions, rapidly raising their earnings growth expectations to record levels, specifically in the US.

The US economy ended last year on a solid footing, with growth firm, the labour market still tightening and inflation rising towards the US Federal Reserve (Fed)'s 2% target. Both business and consumer confidence soared, with private investment, although still soft, expanding for the third consecutive quarter after a lengthy period of contraction. This, of course, paves the way for further Fed tightening and, while there is no clarity as to the timing of the next hike, the forecast is for at least two to three hikes of 25 basis points each this year. There is also the possibility that the Fed may start trimming its US\$4.5 trillion balance sheet – a “passive” form of tightening that will reduce liquidity in the economy and act as a brake on economic activity. It could, of course, be used as an additional policy tightening tool should the Fed perceive a need for this – allowing them to only gradually raise the federal funds rate this year.

## **US POLICY A RISK TO INTEREST RATES AND THE CURRENCY**

The near-term risks to the interest rate outlook in the US are two-fold: the already mentioned growing strength of the US economy and the Trump administration's policy agenda, especially the extent of fiscal easing – both of which could result in the need for further rate hikes. In his first two weeks of office, Trump has done exactly what he promised in his presidential campaign: withdrawing from the 12-nation Trans-Pacific Partnership deal, signing an order to build the Mexican wall and starting talks on introducing a sizeable border tax, among other initiatives. As a result, we expect him to also follow through on his fiscal plans, although the extent of the fiscal easing that will eventually be implemented remains uncertain. Sizeable fiscal stimulus will put more pressure on the Fed to raise rates or tighten policy through liquidity reductions, but such actions will also likely result in a stronger US dollar. For some time now, the Fed has been very cognisant of the risks of a stronger currency, as it ultimately undermines the US's

competitiveness and growth rate. It is also likely to undermine the recovery in emerging markets, where a broadly stable US dollar supported the recent upturn in commodity prices. The bottom line is that the policy outlook in the US remains a key uncertainty for the entire world economy in 2017.

Elsewhere around the world, monetary policy still remains broadly supportive and some emerging market central banks have moved from a tightening cycle to cutting rates. We expect supportive policy settings to remain in place, specifically in Europe, where elections in Germany, France and the Netherlands pose considerable political risk. In Japan, we expect the central bank to keep its accommodative policy stance largely unchanged this year as prospects for reaching its 2% inflation target remain uncertain, even with medium- to long-term inflation expectations lifting.

The long-awaited and much-needed global economic recovery is indeed welcome and is in line with our cautiously optimistic view held for some time now, that global growth would improve moderately in 2017. However, we must note that the threat of rising protectionism, or worse, full-blown trade wars, is a great risk to the growth outlook and hence limits the extent to which the upturn in global economic growth will persist in the medium term. On balance, growth should be stable to higher this year, but there are downside risks posed by trade frictions and US Fed tightening.

## **KEY TAKEOUTS:**

- FISCAL STIMULUS COULD FORCE THE FED'S HAND
- OFFICIALS WARY OF ACTIONS THAT STRENGTHEN THE US DOLLAR
- THE RISE IN PROTECTIONISM IS A RISK TO GROWTH