GLOBAL GROWTH FALTERS AMID TRADE AND POLICY CONCERNS

RIAN **LE ROUX** | STRATEGIST

ABOUT THE AUTHOR

As Sake Economist of the Year, Rian's insight into and forecasts of how macroeconomic developments impact financial markets inform our top-down views.

May was characterised by a stream of concerning news for global investors, causing further volatility in equity, currency and bond markets – a trend that has been in place since around mid-January.

As a result, May saw the US 10-year Treasury yield hit a multi-year high of 3.1% (the highest in seven years), the US dollar firmed further (pressuring emerging market currencies), the oil price continued to rise (breaking through US$80 a barrel for the first time since 2014) and equity markets experienced considerable volatility and diverging performance.

POWER, POLITICS AND TRADE

A stream of unsettling news was responsible for the volatility in financial markets. This included geopolitical tensions stemming from the US withdrawing from the Iran nuclear deal (the key reason behind the oil price surge); concern over the pace of policy tightening by the US Federal Reserve (Fed) as both wages and inflation signs are strengthening; and continued trade tensions as the US administration maintained a very tough stance vis-à-vis its key trading partners and announced potential additional tariffs. Added to these were signs that economic growth outside of the US, notably in the Eurozone, was showing more decisive signs of slowing. To crown it all, concerns over the stability of the Eurozone surged around mid-May as Italy's election outcome, after considerable political turmoil, produced a populist government. The policies of this government might, in due course, bring it in confrontation with the Eurozone.

KEY TAKEOUTS

- GEOPOLITICAL TENSIONS ARE UNNERVING MARKETS
- ITALY CASTS DOUBT OVER EUROZONE STABILITY
- THE WORLD ECONOMY SLOWS, TEMPORARILY

Towards the end of May some of the concerns had eased. These included concerns over the impact of the higher oil price on the world economy, as OPEC indicated it would raise output to prevent a further rise; the immediate dangers to the Eurozone, as the new government coalition in Italy decided to not appoint a vocal anti-EU academic as finance minister; and various indications from the Fed that, while it firmly intended raising interest rates further, it was not seeing reasons to become more hawkish than signalled thus far.

SYNCHRONISED GROWTH CRUMBLING

A key and mounting concern is that the world economy has started to slow. While a protracted and/or deep slowdown is not foreseen, uncertainty as to how long the current "soft patch" in global activity will continue and how severe it might become, continues to trouble markets. In addition, the risk that a midcycle soft patch might be aggravated into something more serious (through global trade spats, policy normalisation as the Fed considers raising rates further, and pressure on developing economies from the stronger US dollar) remains a concern for investors and will likely trouble markets further until more clarity is obtained on these issues.

Despite the concerns mentioned, we remain upbeat about the outlook for the global economy through 2019. Importantly, we continue to believe that the global environment remains structurally deflationary and that the current moderate cyclical uptrend in inflation will not become a serious concern for policymakers, even if inflation were to run above most central banks' targets for a while. In the meantime, global employment and incomes are rising relatively healthily and typical late-cycle capital investment cycles appear to be firming. We therefore maintain our view that the world is in one of the rather common "mini-slowdown cycles" in a longer-term expansion. A more decisive downturn only looms from late 2019, unless global policymakers commit a serious policy error in the interim. ■