Editorial

Growing concerns on economic growth

Growth concerns for both advanced countries and emerging countries have picked up again on the back of a collection of new economic data but also — and perhaps more importantly — due to continued high uncertainty. The latter stems from escalating tensions between the US and China over trade. The effects of this confrontation already show up in the Chinese data while in the US, mounting anecdotal evidence also point to its detrimental impact on business and the agricultural sector. The Federal Reserve has turned a corner and indicated that rate cuts are coming, much to the joy of the equity market. The ECB has also changed its message: with risks tilted to the downside and inflation going nowhere, it considers more easing is necessary.

New records

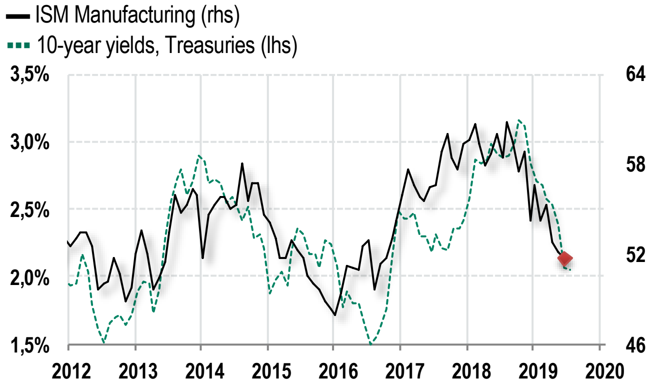
While the S&P500 reached new highs, US treasury yields dropped on the back of a revised outlook regarding the path of monetary policy and further declines in the term premium. Based on calculations by the Federal Reserve of New York, this risk premium, which investors are supposed to receive for taking on duration risk, has reached a record low of -90 basis points at the beginning of July. As shown in the charts, the decline of US bond yields has, quite understandably, mimicked the decline of the purchasing managers index (ISM) for the manufacturing sector. The coincidence of a record high stock market and a record low term premium raises a certain discomfort: declining bond yields reflect unease about the economic outlook, so one wonders how long the stock market can stay immune to these concerns. The drop in US yields has been accompanied by a considerable descent into negative territory of Bund yields as well as yields in other eurozone bond markets. Apart from the usual transatlantic correlation, the change in message coming from the ECB has played a key role in explaining such dynamics. Indeed, if we take at face value the ECB president's speech in Sintra towards the end of June, a new cycle of easing is coming.

Growth concerns on the rise

In the US, while a sigh of relief followed the publication of first quarter GDP data, concerns over growth have since picked up again. The picture is mixed. The pace of job creation remains, on the whole, strong but investment activity is weakening. Market based signals (the inversion of certain parts of the yield curve) have raised recession fears, while increasing anecdotal evidence point to the detrimental impact of tariff increases on businesses and the agricultural sector. Although the US entered its 121st month of economic expansion, it appears that euphoria has largely given way to caution. In the Eurozone, the manufacturing sector, in particular in Germany, remains under pressure, although services are holding up well.

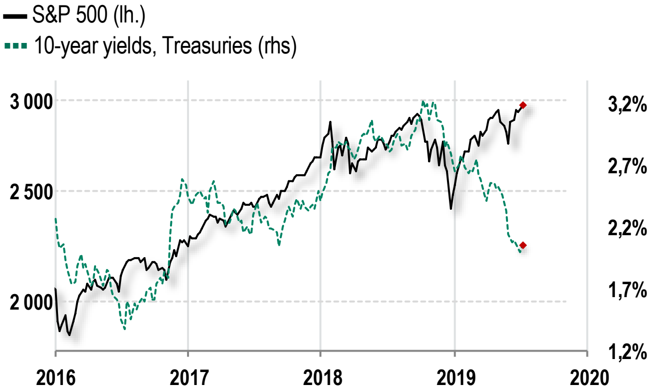
In Emerging Countries (ECs), growth slowdown is still on-going and may worsen in the course of the year. The trade war between China and the US has made the downturn in external trades within Asia worse. Despite official announcements regarding the negotiation process, external demand will remain a major impediment to growth for ECs, not only in Asia but also in Latam and MENA. Metal prices and oil prices are trending downward since respectively mi-2018 and Q4 2018 and agricultural prices have stagnated since mid-2015. The painful of a number of commodity exporters is not over.

US Treasury yields vs ISM Manufacturing



Source: Institute for Supply Management, Refinitiv

S&P 500 vs US Treasury yields



Source: Refinitiv

The decision by the group of OPEC+ countries to renew the production quotas adopted at year-end 2018 will make the recovery very gradual.

Except for Central European countries, domestic demand will not compensate for the weakness of external demand notably for almost all the major ECs (China, India, Brazil, Russia, Mexico, Turkey, South Africa, GCC countries as a whole). Firstly, monetary policies will remain cautious. Secondly, there is a fiscal room of manoeuvre only in China, Russia, Turkey and GCC but at the expense of debt stability (Saudi Arabia) or financial stability (Turkey). In any case, the fiscal stimulus will be used with great moderation.

Tipping point

Against this background of increased growth concerns, the key question for the coming months remains whether a tipping point will be reached. Fundamentals (labour market, income growth, corporate profits growth, interest rates) are, on the whole, still satisfactory, but a protracted period of uncertainty could weaken the influence of these fundamentals on growth. This in turn could weigh on confidence and market behaviour and trigger a negative feedback loop. A reduction in uncertainty would obviously provide a boost of confidence and create an uptick in growth. Trade negotiators should keep this in mind when they meet.

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