

Editorial

Lingering concerns despite hopeful signs

Recent data in China and the eurozone point towards a stabilisation of growth and have been met with relief. Although the US economy is slowing, growth should remain at a satisfactory level in the near term. Yet there are lingering concerns about the underlying strength of the global economy. The IMF has again scaled down its forecasts and only expects a modest growth pickup later this year. The flattening of the US yield curve fuels worries that growth will disappoint. The Fed insists it is confident about the outlook and patient in setting its policy. Markets have welcomed this accommodative message. Yet the signals sent by equity and bond markets about future growth are quite different. It only adds to the list of concerns.

■ Hopeful signs

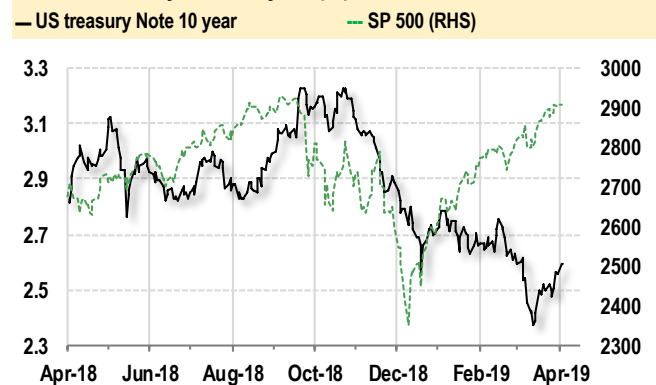
Following months of ever softer readings, recent indicators pointing towards some improvement have been met with relief. In China, the rebound of the purchasing manager indices for March, albeit to a level barely above the 50 mark, has been followed by a first quarter GDP growth of 6.4% y/y, unchanged from the previous quarter and slightly above expectations. This provides hope for Chinese trading partners and in particular Germany, where export assessments had dropped very significantly in recent months. German data have ticked up as well in services, trade and construction, but with the notable exception of manufacturing, which continues to suffer. The services purchasing manager index improved in March for the eurozone, as well as in Italy and Spain, whilst remaining stable and well above 50 in Germany. Data in France have also improved somewhat. In the US, the dismal job numbers of February have been followed by strong data for March.

■ Lingering concerns

Despite the hopeful signs, concerns remain for a host of reasons. One is the flattening of the US yield curve. Its lead time with respect to the start of a recession is variable and years of expansionary monetary policy, including quantitative easing, have quite likely influenced the shape of the curve. Yet the historical record as a rather reliable leading indicator may end up influencing the real economy by instilling a more cautious mindset when deciding on corporate investment or bank lending. The April Duke University survey of CFOs of 469 US companies showed that 38% expect a recession by the first quarter of 2020, 67% by the third quarter of 2020, and 84% by the first quarter of 2021. There is also the question of whether the improvement in Chinese data will be self-sustained or require ongoing stimulus measures. A third question mark is the delayed effects of protracted uncertainty. The news on the US-China relations suggests that an agreement will be reached, but concrete implications remain to be seen (improved market access? Trade diversion?). In the meantime negotiations between the US and the EU have started, which may become a new source of uncertainty. In addition, the Brexit outcome remains unclear. The semantics of the IMF's April World Economic Outlook provide a sobering assessment (emphasis added):

"The global growth forecast reflects a combination of waning cyclical forces and a return to lepid potential growth in advanced economies; a precarious recovery in emerging market and developing economies, driven to a great extent by economies currently experiencing severe macroeconomic distress; and complex factors that shape the prospects for potential growth in both groups."

■ US Treasury Note 10 year (%) vs SP 500



Source: Federal Reserve, Standard and Poor's, BNP Paribas

■ Risk appetite fluctuates between monetary support and growth fears

As a consequence, the tone of central banks has evolved. Faced with a slowing economy and low inflation (core inflation at barely 0.8% in March in the euro area), the ECB will roll out another targeted long term refinancing operation (TLTRO). This should serve to stimulate credit growth against the background of softening credit demand from companies, as reflected in the latest bank lending survey. The Federal Reserve, benefitting from a combination of above trend growth and stable, close to target, inflation, has repeatedly insisted on its patience in contemplating a change of its policy rate. This monetary support has been instrumental in triggering a rebound in equity prices and the S&P500 index is now close to its record of end September 2018. 10 year US treasury yields on the other hand are still 70 basis points below the level of end September. When markets send conflicting signals on growth, there is reason to be vigilant.

William De Vijlder

william.devijlder@bnpparibas.com

