Editorial

Towards a slight growth pick-up

In recent months, the global manufacturing cycle has been bottoming out whereas in services a slight uptick has been noted. In addition, two major sources of uncertainty have seen a positive development: the US and China signed a trade deal and the UK and the European Union can at last start negotiations about their future relationship. Very accommodative central bank policy has contributed to buoyant market sentiment. The combination of these three factors - stabilisation of business sentiment, decline in uncertainty, supportive financial environment - implies conditions are met to see some uptick in growth. Nevertheless, caution prevails in this assessment, if only because later on this year, uncertainty may very well increase again.

Stabilisation of survey data

As illustrated in the chart, with the exception of Japan, the pace of decline of the OECD composite leading indicator is slowing which would suggest that in due course, some growth pick-up should follow. Recent business survey data have also brought some hope. Manufacturing purchasing manager indices have stabilised globally. Some economies have seen a slight increase from the lows seen in the summer and autumn of 2019 (eurozone, Germany, China) although the level remains low. Services PMIs are doing a bit better and the much dreaded spillover coming from last year's manufacturing slowdown has been avoided to a large degree. Importantly, export order assessments have also improved although the levels remain very low.

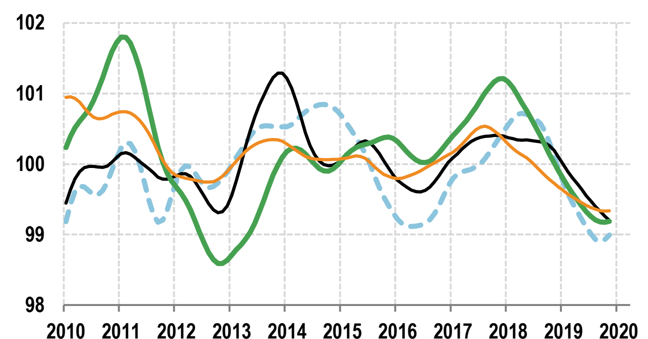
Easy financial and monetary conditions

The Federal Reserve and the ECB have accompanied last year's policy easing decisions with an (implicit) message that official rates will stay very low level for quite some time. Although the Fed's policy is data-dependent, the bar for considering a rate hike seems to be high and the necessary acceleration of inflation to tip the balance is very unlikely any time soon. Christine Lagarde's statement that an inflation rate of 1.6% as projected by the ECB for 2022 would not correspond to the aim that the central bank pursues, suggests that no rate hike is to be expected before the end of 2022, unless the ECB staff would have underestimated the inflation dynamics. This in turn would require a significantly faster growth of activity and wages, which doesn't look to be on the cards. This very accommodative monetary policy environment continues to stimulate the risk appetite of investors, all the more so given the decline in uncertainty, as explained below. The ensuing rally in equities has found its mirror image in an increase in government bond yields, reflecting the view that investors consider the economic outlook to have become somewhat less risky. All in all, financial and monetary conditions have eased, which, all else being the same, should end up supporting growth.

Uncertainty has declined, for now

Two issues which have been major sources of protracted uncertainty have seen a positive development as of late. In the UK, the huge victory of Boris Johnson in the December general election paves the way for a negotiation with the EU about the future relationship, easing fears of a no-deal hard Brexit. The signing of a trade deal between the US and China has avoided a new intensification of the trade war.

OECD composite leading indicator



Source: OECD, BNP Paribas

In addition, markets have reacted very calmly to the rising tensions between Iran and the US at the start of the year. They consider the risk of a major escalation as being very small. However, it can't be excluded that later on this year, uncertainty makes a comeback. Concerning the UK-EU negotiations, not enough time is left to strike a comprehensive deal by year-end. This, in combination with recent statements by the UK Chancellor of the Exchequer about his country's intentions to set its own rules and regulations suggest that negotiations will be tough. With respect to the US-China trade deal, it offers, upon closer inspection, little reason for cheer. It is an example of managed bilateral trade and thus creates trade diversion to the detriment of third countries, it maintains the bulk of the significant increase in tariffs introduced on both sides since the start of 2018 and, most importantly, it is only a phase 1 deal. Phase 2 negotiations – expected to start after the US presidential election in November 2020 - may very well be even tougher whereby the reciprocal threats of trade sanctions would end up dominating headlines again.

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