

# Editorial

## Uncertainty overshadows the cyclical environment

*The slowdown is spreading widely. Although it is reasonable to expect growth to normalise, several sources of uncertainty (fears of a trade war, Brexit, the US government shutdown, etc.) are acting as headwinds. China has already announced new measures, and in the United States, the Federal Reserve is insisting on its patience (concerning inflation) and flexibility when it comes to adapting monetary policy.*

Human nature is inclined to risk aversion: people are more sensitive to losses than to opportunity costs. A slowdown almost inevitably creates discomfort, due more to fears of what might happen than to the actual squeeze on earnings or revenues. Households postpone big-ticket purchases, companies slash their investment budgets, and banks become more wary about granting loans. In brief, slowing growth endogenously generates uncertainty, which only reinforces the sense of losing momentum.

Against this backdrop, we must add the exogenous shocks arising from political decisions over the past several months: US-China trade tensions, American threats of protectionist measures aimed at the European automobile sector, the government shutdown in the United States, and in Europe, Brexit, where the situation remains totally opaque just two months before the date when the UK is set to leave the European Union.

This picture must also be rounded out with specific factors pertaining to certain countries: new anti-pollution standards that are hitting the European automotive sector, notably in Germany and France; social unrest in France; and uncertainty over the Italian budget, which has had a lasting impact on interest rates even though an agreement was reached with Brussels for 2019. China's efforts to get a grip on lending trends has also contributed to a structural slowdown. All of this has tended to drag down survey indicators in most countries since early 2018. More recently, growth figures are also trending downwards. Towards the end of the year, the slowdown even spread to the United States, which has long resisted economic headwinds thanks to an expansionist fiscal policy.

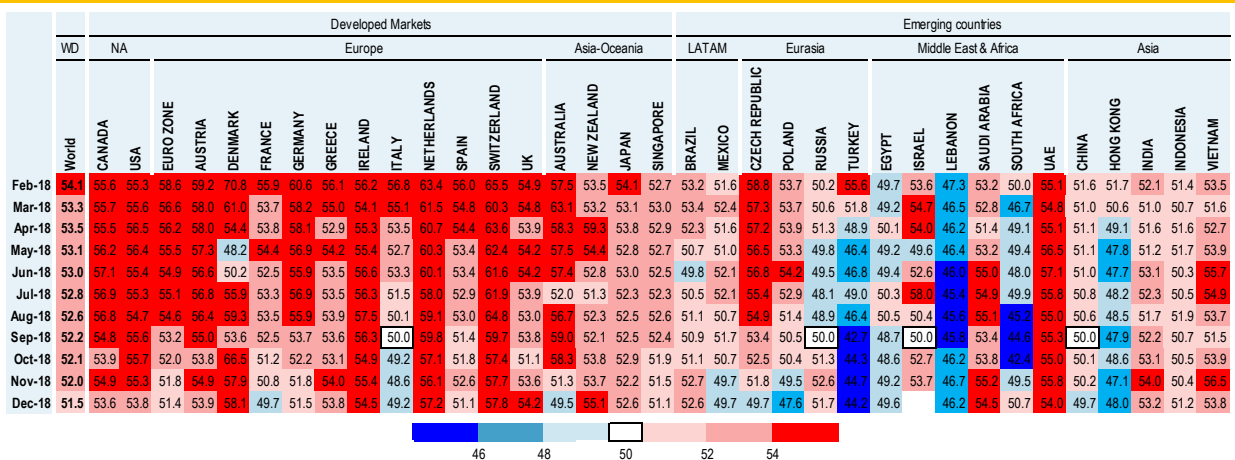
Confronted with the decline in these key indicators, the central banks have considerably softened their stance since the beginning of 2019. Federal Reserve chairman Jerome Powell insists on the Fed's patience – since inflation remains under control – and on its flexibility, thereby sending an implicit but clear message that the Fed will not remain passive in the face of deteriorating prospects. Speaking before the European Parliament, Mario Draghi insisted that figures were weaker than expected and for a longer period than anticipated. It can no longer be taken for granted that the first key deposit rate increase will occur next fall. In China, the central bank has cut the banks' reserve requirements, which means they will be able to step up the volume of lending.

These positive signals do not really change the situation. The slowdown in the world economy is not due to financing troubles or excessively high real interest rates. It reflects doubts about the sustainability of the expansion, which are largely fed by growing uncertainties. In China, for example, this is why fiscal measures (tax cuts to stimulate spending and bond issues to finance infrastructure investment projects) should have more of an impact than monetary measures. From a more fundamental perspective, it is urgent to eliminate the sources of uncertainty to prevent a simple slowdown from festering into something more severe. Several signals recently suggest a slight improvement in US-China trade negotiations, since it is in the interest of both sides to prevent growth from contracting. As to Brexit, in contrast, it makes perfect sense to exclude the possibility of a no-deal Brexit given its extremely negative consequences. Yet fears of a hard Brexit persist and continue to act as a headwind for both the UK and the European Union.

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Heatmap of manufacturing PMI



Source: Markit, BNP Paribas

