THE COLLAR AROUND GLOBAL GROWTH

Suttle Economics Notes #95

- Global growth recovered in 2019H1 from its latest weak point in 2018Q4
- The rebound has not been convincing: momentum does not look great heading into 19H2
- The downside is supported by policy: goods-producing sectors should show improvement
- The upside is capped by business uncertainty: de-globalization is a durable bad

Chart 1
Selected real GDP growth rates
% over 2q, saar

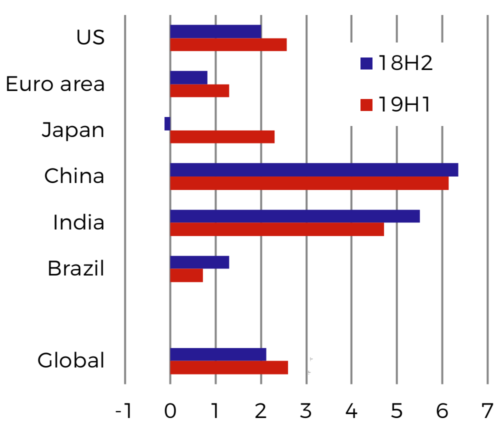
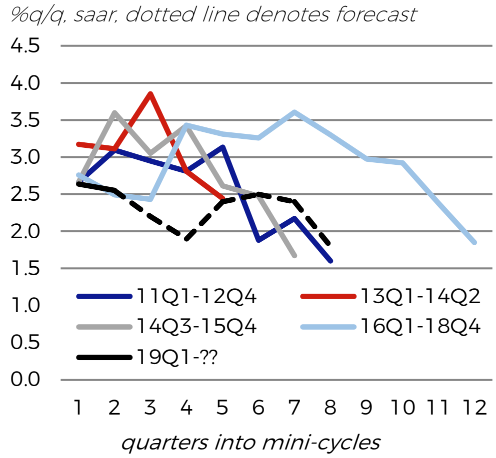


Chart 2
Global real GDP growth since 2010
%q/q, saar, dotted line denotes forecast



With the global round of Q2 real GDP data now almost complete, the acceleration in global growth in 2019H1 versus 2018H2 is still just about intact (Chart 1). Global growth slowed to 2.5%q/q, saar, in Q2, held down by a deceleration in growth in developed market (DM) economies, which moderated from 2.4%q/q, saar, in Q1 to 1.5%q/q, saar, in Q2. This moderation was offset by an uptick in growth in emerging market (EM) economies, from 3.1%q/q, saar, in Q1 to 4.6%q/q, saar, in Q2. For 2019H1 overall, DM economies did a little better than in 2018H2, while the reverse was true for EM economies.

In our view, we have just entered the fifth mini-upswing phase of the current expansion. 2018Q4 was the end of the last mini-upswing, which was also the longest of the expansion-to-date (Chart 2). 2019H1 exactly matched the first two quarters of that last mini expansion phase. If the analog is to hold, then we might see another slightly softer quarter in Q3 before a global growth acceleration into 2020. Our forecast (dotted lines in Chart 2) is more cautious, however, as it looks for a dip into 19Q4, followed by a muted rebound through 2020, which fades as 2020 progresses, setting us up for a difficult 2021.

One factor causing weakness into year-end is the expected drag from Japan's Q4 sales tax hike, which is likely to reverse some of Japan's surprising growth acceleration through 2019H1. More generally, however, we think the global growth path is constrained by powerful forces on both the upside and the downside.

It is constrained from below by support from policy—both monetary and, to a lesser extent, fiscal—made possible by the perception, if not the reality, of a low-inflation environment. The natural working of cyclical forces (an inventory-accelerator) mechanism will also help to push growth up. Global growth is constrained from above by the political and economic forces making for de-globalization. This powerful force threatens to strand significant portions of the global

Chart 3
G3*: financial conditions
Goldman Sachs indices; higher is tightening

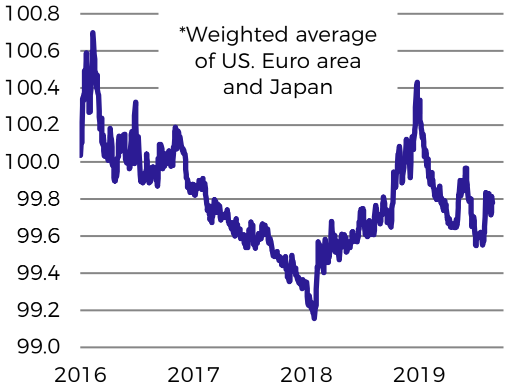


Chart 4
DM*: housing growth contribution
% points of GDP, last 2q, saar

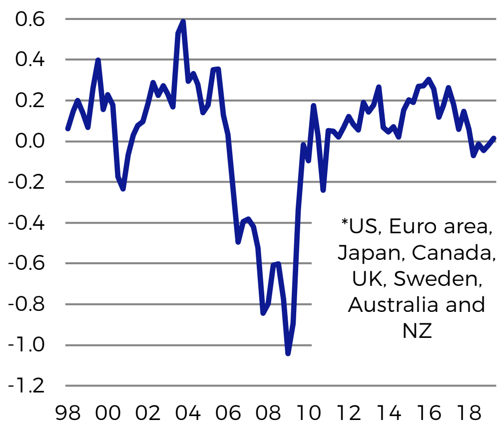
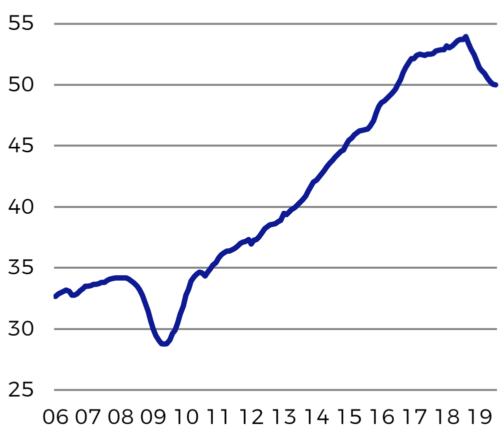


Chart 5
Auto sales: US, China and Euro area
million, latest 12 total



capital stock in the wrong locations, making businesses more cautious about new spending (and hiring); and more apt to save in coming quarters.

One question is whether a reversal of some of the dislocative forces that have caused global weakness might take the upside cap off global growth, allowing for an extended improving run to 2020-21. What might happen, for example, if trade peace breaks out between the US and China and Brexit is either reversed or handled in a smooth fashion?

We have our doubts about this upside being realized for two reasons. First, it will prove difficult to put the de-globalization genie back into the bottle. If President Trump fails to win a second term in November 2020, then his likely Democrat successor might well continue his protectionist policies. As was made clear by the TPP debate ahead of the last election, anti-globalization sentiment now enjoys bipartisan support. Second, the room an extended upside run in global growth is limited by capacity constraints (especially tight labor markets) which are apt to show in higher inflation, squeezed profit margins and, ultimately tighter policy. De-globalization could intensify these problems as it limits the extent to which excess demand pressures in some DM economies (e.g. the US and UK) can be met by imports or immigration.

Policy support from below
Upside support for global growth is provided by monetary easing and its spillover to easier global financial conditions (Chart 3). Today's multi-pronged ECB easing (rates, accompanied by efforts to improve bank transmission, and more QE) will be followed next week by a rate cut from the Fed, even though macro conditions (as reflected in traditional feedback rules) would not suggest one as wise or necessary. As with the path for growth, the easing in G3 financial conditions in 2019 looks quite similar to that in 2016.

Fiscal policy has also become somewhat easier and policy-makers have been vocal in calling for more. The fiscal hawks have gone quiet amid ultra-low long-term bond yields. The extent of DM fiscal easing was at its maximum in 2018, when sizeable US easing was underway. In 2019, the degree of net new fiscal easing in the United States was much reduced, but DM easing was more broad-based. 2020 is shaping up to be a year of modest fiscal easing (about ¼%-point) across a broad array of DM economies.

Easier policies at work
There are four goods-producing pressure points to watch to assess whether and how well easier financial policies are working their way through the global economy to provide growth support from below. Housing is the most credit-sensitive sector. The

Chart 6
Manufacturing PMIs by region
50 = stable activity, 34 country sample

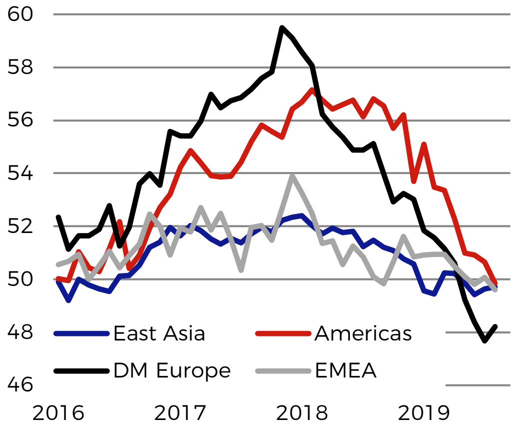


Chart 7
Inventory contributions to growth
%-points of real GDP, saar

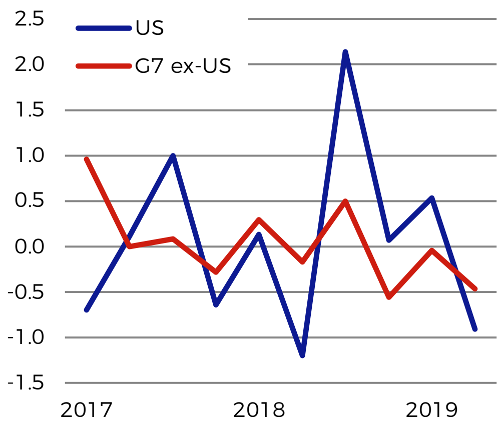
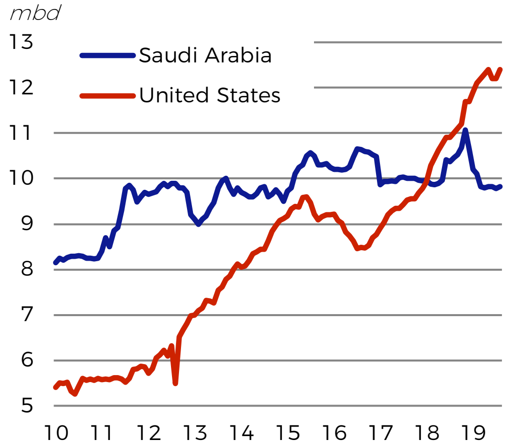


Chart 8
Saudi Arabia and US: oil production
mbd



slowing in DM housing knocked about ¼%-point off DM growth from the 2017Q1 to 2018Q4, with that moderation concentrated in economies that either hiked rates (the US, Canada or the UK) or adopted tougher regulation because of macroprudential concerns (Australia and Sweden; Chart 4). In aggregate, housing has begun to improve off its lows, and this development should continue in coming months.

Second, auto sales should rebound, although much of this depends on the path of regulatory issues, which have been an important source of weakness in sales in both China and Europe (Chart 6). Globally, the auto sector has been among the hardest hit in the recent downturn, with sales falling (on a trailing 12m sum) since 2018Q3 by not much less than in 2009.

Third, easing should work to stabilize goods producing sectors (especially manufacturing). Easier credit works to buoy final sales (e.g. auto sales); it also helps to finance increased inventories and thus reduce pressure for their rapid liquidation. More generally, the exhaustion of the down-leg of an inventory cycle is an important channel through which global growth finds a trough. Manufacturing remains unusually weak relative to the rest of the global economy (Chart 6). The US manufacturing cycle looks to be somewhat lagged relative to elsewhere. The aim of US protectionism had been to tilt developments back in favor of US producers, so this lag should have been expected. The US inventory cycle is taking longer to play out than in other economies, where inventories have been a drag on growth for much of the past couple of years (Chart 7).

Finally, easing works through promoting commodity production. In the United States, surging oil production has been an important feature of the two phases of relative strong growth through the current expansion: 2013-14 and 2017-18 (Chart 8). Technology and, more recently, de-regulation will have played more important roles. There is now a risk that the US oil output boom runs out of steam again (thanks to stable-to-lower prices), which might damp overall growth even as the three channels observed above gain in momentum.

The business sector response to easier policy

The interest-sensitivity of business fixed investment has long been questioned. Fed research suggests that firms unconstrained by finance (and thus the need to borrow) are far less interest-sensitive (in both directions). The fact that the non-financial corporate sector has generally maintained a very conservative financial buffer throughout this expansion suggest that more firms may well have become less interest-insensitive.

Chart 9
G7 business fixed investment
% change over past 2q, saar

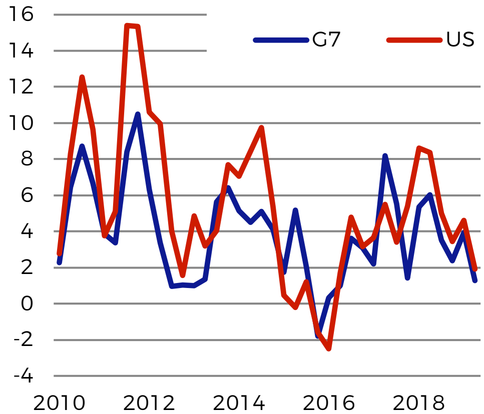


Chart 10
DM employment growth
%3m/3m, saar

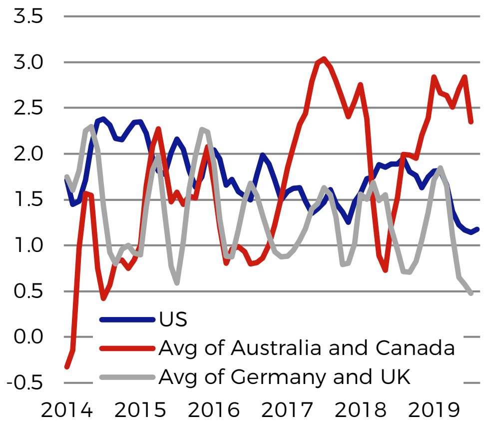
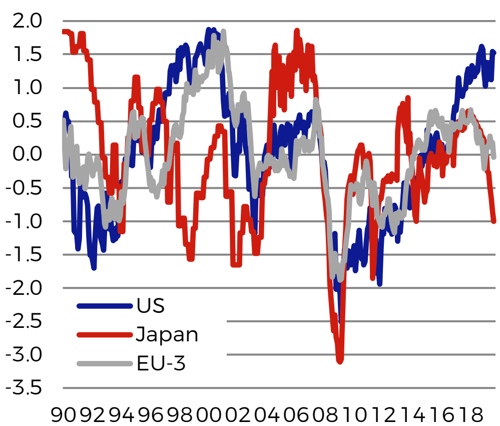


Chart 11
DM consumer confidence
z-scores, 1990-2019 window



The last low in the G7 business fixed investment cycle was coincident with the overall low in growth: 15Q4/16Q1 (Chart 9). This time around, however, investment has slid in 2019H1, even as overall growth has picked back up. This capex weakness may be partly related to commodity concerns noted above (i.e. oil exploration outlays). A bigger worry, however, is that it is related to concerns about de-globalization due to geopolitical risk factors (President Trump's tariffs and associated retaliation; hard-Brexit fears; and the recent trade spat between Japan and Korea).

Consider the example of a Japanese car company looking to invest abroad. Previous outlays in Mexico and the UK designed to position the company for sales into the rest of the relevant economic region no longer looks quite so wise. In both cases, it is hard to predict the regulatory framework with any confidence two years out, let alone ten.

A bigger worry is that business caution reaches a point where companies start trimming employment, even amid stimulative policy (Chart 10). We track DM employment data on a monthly basis from 6 major economies (Japan is not shown). Average employment growth has weakened across these economies in 2019, led by the Brexit-damaged UK and Germany. US employment growth has also slowed. By contrast, job growth in Australia and Canada has picked back up (an example of the growth benefits of higher commodity prices). It is hard to know whether slowing employment growth reflects weaker demand rather than slower labor force growth. In Germany, unemployment has risen, hinting at a demand short-fall.

The knock-on concerns of weaker employment growth would be that it undermines the consumer. To date, the US consumer sector remains very robust, as reflected in consumer confidence at a near-record high (Chart 11). European consumer confidence has fallen, but it nowhere near the low registered in 2012. Paradoxically, the low-side outlier is Japan, where August consumer confidence touched the level of April 2014, when the national sales tax was last hiked.

Philip Suttle
phil@suttleeconomics.com
202-378-6793