CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Riskier outlook for the global economy

Global economic concerns have been very much to the forefront of the market discourse over the past number of weeks. Last week saw softer than expected data out of China and the confirmation that the German economy contracted in the second quarter adding to fears regarding the global economic outlook.

These worries were compounded by yields on US 10 year bonds falling below the yield on 2 year bonds for the first time since 2007. This so called 'inversion' of the yield curve has preceded recessions in the US economy over the last 50 years.

These developments prompted a bout of risk aversion on markets. The major global equity indices fell sharply. At the same time, bond markets were sought out for their safe haven appeal. This was evident in the German 10 year bond yield falling to a new all-time record low of -0.73%.

It must be noted, though, that US economic data are not signaling that the economy is in major difficulty at the moment. Key metrics such as payroll growth and consumer spending are all consistent with solid growth in the world's largest economy.

Backing up this point, US Fed Chair, Jerome Powell, stated at the central bank's most recent monetary policy meeting, that the "outlook for the US economy remains favourable". More recently, another key Fed official, James Bullard, commented on the good shape of the US jobs market and the strong level of consumer spending.

Growth in the US economy, though, is expected to lose momentum as the fiscal stimulus there fades. In this regard, the IMF, in its recent update to its World Economic Outlook, is forecasting US economic growth of 2.6% this year, moderating to 1.9% in 2020. This would still make the US one of the best performing advanced economies over the period.

In terms of the prospects for the overall global economy, the IMF noted that growth remained subdued, especially in relation to fixed investment. A key reason it outlined for this subdued performance in global growth is the weakness in manufacturing. This reflects muted business investment and reduced consumer spending on what it termed 'big ticket' items such as cars.

The IMF interpreted these developments as an indication that both business and households are holding back on 'long range' spending amid heightened policy uncertainty, including in relation to global trade tensions and Brexit. Slower growth in global trade is also reflective of more muted spending patterns among businesses and households.

One bright spot has been the services sector, where despite losing some momentum, activity levels remain at solid levels. This in turn has supported employment growth.

In terms of the outlook, the IMF is expecting that the global economy will grow by 3.2% in 2019 and pick up to 3.5% in 2020. Global growth was recorded at 3.6% and 3.8% in 2018 and 2017, respectively.

Overall, considerable uncertainty persists about the prospects for the global economy. Thus a careful eye will need to be kept on the incoming data, especially business surveys. It would be especially encouraging to see an improvement in manufacturing activity. An easing in global trade tensions, in particular a resolution of the US-China trade war, would be a positive development for the sector and improve the growth prospects for the world economy.

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