Economist's Weekly Market View

Pick-up in global growth unlikely to last

GDP data for the first quarter of the year have now been published for virtually all the main world economies, except Japan. They show an unexpected pick-up in the pace of growth everywhere, with some quite strong performances, most notably in the US where output grew by 0.8% (3.2% annualised) and the Eurozone and UK where GDP increased by 0.4% and 0.5%, respectively.

Thus, while survey data for the opening months of the year suggested that growth would remain weak in quarter one, this has not proved to be the case. Much of the recent weakness in global activity has been concentrated in the manufacturing sector. This is now a small part of most modern economies, accounting for circa 10-15% of GDP, with Germany a notable outlier at over 20%. The weakness in manufacturing activity is associated with a slowdown in global trade in recent quarters, which has seen a decline in new export orders.

By contrast, the large services sector continued to perform quite well in most economies during quarter one. Furthermore, labour market data have remained strong, with continuing good employment growth and a further fall in unemployment in the early part of this year. This is contributing to accelerating wage growth.

Not surprising then, consumer spending performed well in the first quarter, with particularly strong growth in retail sales in the UK and Eurozone, including Ireland. Consumer expenditure remains the key component of demand in developed economies.

However, there were also some warning signs in the GDP reports for the first quarter. The stronger than expected growth was in part due to a build-up of unsold inventories. These are likely to be run down in this quarter, with both the Federal Reserve and Bank of England warning that this is likely to see growth slow again.

Meanwhile, underlying inflation was also weaker than expected in the opening quarter of the year. This means that central banks can remain patient about tightening monetary policy despite the better than expected economic growth in quarter one. Recent central bank meetings have seen the guardians of monetary policy emphasise that rates remain very much on hold at the present time.

The combination of better than expected growth and continuing very low interest rates have formed a very supportive backdrop for stock markets in 2019. Despite a wobble in the past week, most of the major world equity indices are still up by 10-15% year-to-date. Meanwhile, subdued inflation and continuing low rates have seen bond markets also rally this year.

Thus, there has been a marked easing in financial conditions, which is positive for economic growth prospects.

However, trade tensions continue to escalate, most notably between the US and China. This is contributing to the slowdown in international trade. There was also a notable weakening in activity in the services sector in April, with the Global PMI for the sector falling to 52.7, from 53.7 in March.

Not surprisingly then, central banks and most other forecasters remain cautious about the economic outlook. It is too early to sound the all clear for the world economy after one quarter of better than expected growth. Indeed, the likelihood is that growth will slow again in the second quarter. Hence, central banks are likely to remain on the sidelines for some time, keeping rates at their current very low levels.

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