Marketing Communication For Professional Investors

MACRO-ECONOMIC OUTLOOK FOR 2020

2020 – SLOWER GROWTH BUT NO RECESSION

- **Manufacturing activity has fallen to levels not seen since the global financial crisis; rising trade and geopolitical tensions raise downside risks to business activity**
- **But domestic demand is holding up well**
- **And discussions are underway about a greater role for fiscal policy**

As 2019 progressed, there were growing signs of a slowdown in manufacturing activity, triggering investor concerns over a marked slowdown in the world economy or even a recession.

The negative effects of protectionist policies have yet to be seen in full, but the lack of visibility on the Sino-US trade negotiations has begun to undermine business confidence.

Business confidence surveys have not recovered convincingly, and in Europe have even deteriorated significantly.

All this has led to downward revisions of growth forecasts for 2019 and 2020 in most major developed and emerging economies.

Against this background, and as the uncertainty began to hurt stock markets, the continued absence of inflationary pressures has enabled central banks to further ease monetary policy.

We do not anticipate a major change to this environment in 2020. We reckon with another year of modest growth and low inflation, supported by accommodative monetary policies and, perhaps even some budgetary stimuli.

In our view, this will be enough to prevent a recession.

GLOOM DOESN'T MEAN DEPRESSION

Downward risks to global activity have increased. Uncertainties linked to the trade conflict between the US and China and, more generally, protectionist US policy have weighed on business sentiment around the world.

In the manufacturing sector, the global Purchasing Managers' Index (PMI) fell to below 50 in May 2019, indicating a contraction in industrial activity. It fell to 49.3 in July, its lowest since mid-2009. In October, it stood at 49.8. The results of this survey have been disappointing for many months and explain, in part, the downward revisions to the growth prospects that characterised 2018 and 2019.

In recent months growth estimates have been repeatedly revised downwards. This 'news', which sometimes made the headlines, was not really new, but it may have contributed to the general sense of gloom and stifled corporate investment, and thus influenced the results of the business surveys. Possibly to break this vicious circle, the main central banks adopted a dovish stance early in 2019 before easing monetary policy.

Over the long term (1980-2018) the average level of global GDP growth has been 3.5% so a pace of 3% indicates sluggish economic conditions.

The IMF forecasts a rebound for economic activity in 2020. Our view is that the global economy should avoid recession in 2020, although risks of a synchronised slowdown have increased.

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PROTECTIONISM AND DE-GLOBALISATION WILL REMAIN HEADLINE NEWS

The risks for 2020 arise mainly from the uncertainties linked to the prolonged US-China trade conflict. So far, the available data has not shown a collapse in world trade since the beginning of the year, but rather an erratic pattern. Some companies were able to bring forward exports before higher tariffs came into force and leading indicators of world trade have not signalled global trade paralysis.

The direction of trade policy throughout the world indicates, in our view, a move towards 'de-globalisation,' but this should remain partial and limited. This trend should still be part of the picture even if a (limited) US-China agreement is signed. It will have long-term consequences for broader economic conditions.

In the short term, we can reckon with electioneering in the run -up to the November 2020 US presidential elections. President Trump may try his luck with new tariffs on European products and this will likely add to market and economic volatility.

Business leaders, investors and economists will not be able to escape concerns over the trade war. It is therefore not unreasonable to ask whether domestic demand can withstand this extended period of uncertainty. However, we see a number of factors supporting domestic demand. We do not believe that the rise of protectionism should be viewed as an exogenous recessionary shock that will throw the global economy into recession.

2020: MODERATE GROWTH WITH LOW INFLATION. YES, MORE OF THE SAME...

In the **US**, after more than 10 years of economic expansion, growth could have slipped slightly to below potential at the end of 2019 but it should remain solid in absolute terms in 2020. It should certainly maintain a more favourable momentum than in Europe or Japan.

The job market has been doing well with unemployment at record lows and the fall in interest rates has continued to support the housing market.

In the **eurozone**, despite repeated disappointments in surveys of business activity and confidence, hard data has shown no significant deterioration. GDP growth is expected to come in at 1.1% for 2019 after 1.8% in 2018. Several fundamental elements have pointed to an acceleration in consumption, and investment surveys appear to have overestimated the downside risks to demand. The accommodative policy measures implemented by the ECB and calls for a support via fiscal policy should continue to prop the economy up.

In **China**, GDP growth has remained on a downward trend, which should take it to 6% in 2020, with stimulus measures offsetting the effects of the trade conflict with the US.

Inflationary pressures remained subdued in 2019, allowing central banks to ease monetary policy. For 2020, the risks of a pick-up in inflation cannot be completely dismissed, particularly in the US where conditions in the labour market are tight, but inflation should not threaten the global economy as a whole. We believe this leaves plenty of scope for monetary policy to remain accommodative and, more broadly, for adjustments in economic policy.

WILL 2020 SEE THE FISCAL STIMULUS TAKE OVER FROM MONETARY POLICY?

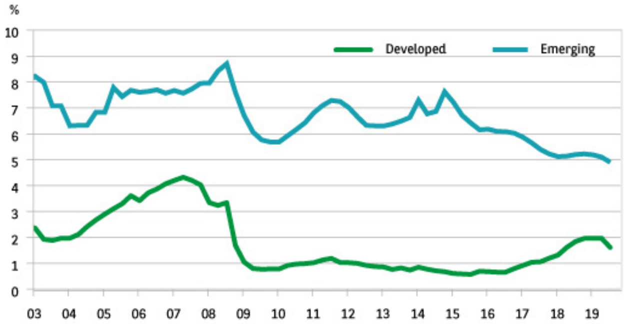
Our 2019 outlook was entitled Regime change. We talked about 'future monetary policy normalisation' and 'life after quantitative easing'. We are still waiting. Admittedly, the Fed did plan to raise its key rates three times in 2019, and the ECB had indicated that it would stop its net purchases of securities in January 2019, but the parallels with Japan are hard to ignore.

Now, almost a year later, the Fed has cut its key rates three times to bring the federal funds target rate back to a range of 1.50%-1.75%. Meanwhile, the ECB lowered its deposit rate by 10bp to -0.50% and resumed its asset purchase programme (APP).

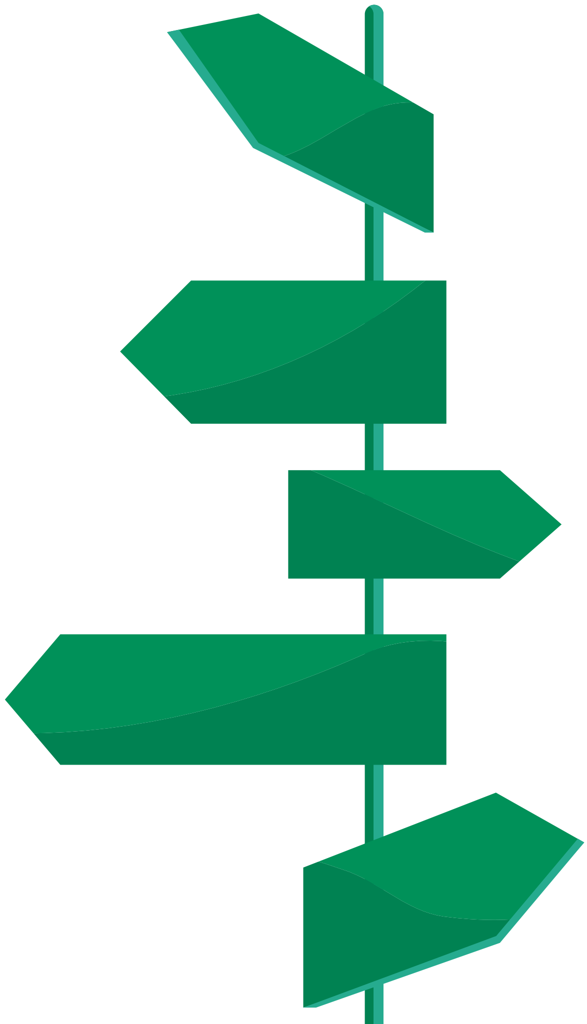
Many other central banks eased monetary policy in 2019, particularly in emerging markets. The People's Bank of China (PBoC) has cut its reserve requirement ratio (RRR) by 400bp since the spring of 2018, with a special focus on smaller banks (-600bp). It has pre-committed to further cuts to boost credit. China's policymakers have already suggested that supportive budgetary efforts will continue.

CHANGES IN POLICY RATES AT CENTRAL BANKS IN DEVELOPED AND EMERGING ECONOMIES, 2003-2019

Central Bank Key Interest Rates



Source : Bloomberg, BNPP AM
As of 30/11/2019



Will China lead the way to economic recovery in 2020 and greater cooperation between monetary and fiscal policy? It is difficult to give a definitive answer, but calls for government investments to stimulate economic growth increased late in 2019.

Christine Lagarde, the new president of the ECB, already commented that governments running chronic budget surpluses were failing to do their part to support the economy and should be the object of greater scrutiny.

As concern grows about the corrosive side-effects of negative interest rates and the ECB's bond-buying programme nears self-imposed limits, it is doubtless time to look again at fiscal policies. They would change the outlook on many fronts. The topic will certainly be fuelling debate in the coming months.

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