Daily Note

WHO KILLED THE SYNCHRONIZED BOOM?

Dario Perkins

- **The 'synchronized global growth' theme disappeared in 2018**
- **Instead, 'US outperformance' has been the main macro narrative**
- **Trade wars & oil are the main threats to an already soggier outlook**

Thinking back to the start of the year, it is clear 2018 hasn't gone the way the consensus was hoping. In January, most 'Year Ahead' reports were all about synchronized global growth creating an extremely benign trading environment. Without naming names, one investment bank said this year's outlook was '*as good as it ever gets*'. Two others suggested this would produce a backdrop of '*rational exuberance*' for asset markets. Yet, by the spring, the global economy was already facing a not-insignificant growth scare. China and Europe had slowed, with various canaries in various coalmines unexpectedly meeting their makers. The bears became suitably animated, bringing forward their perma-depression calls. We were told to watch Korean and Swedish exports closely, as these were 'bellwethers' for a wider international slump. Since then, growth has remained rather soggy but the bottom hasn't yet fallen out of the global economy – despite irritating trade tensions, periodic market volatility and now rising oil prices.

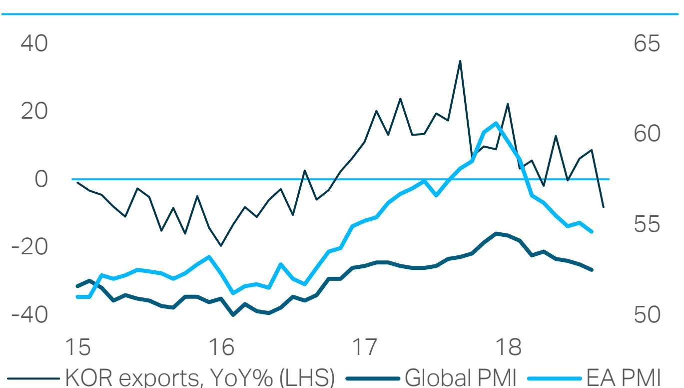
While there is nothing particularly scary about the slowdown we have seen so far, the synchronized global growth narrative is gone, replaced by the 'US outperformance' theme. The economies of China and the euro area remain subdued, while the US has accelerated to an above-trend pace. Why has this decoupling happened? Divergent government policies have clearly played a role. The Chinese tightened fiscal and monetary policy sharply through 2017, while the Americans introduced a sizeable fiscal boost. We can see the impact of China's slowdown in international trade and production data. As we've noted in the past, China's stop-go policy cycle always has a material impact on the global economy, with each wave of new stimulus and tightening influencing the rest of the world with a lag of up to12 months. Europe is

US GDP forecasts revised higher

expected growth differential, one year out (rolling period)

Source: Bloomberg, TS Lombard

Global slowdown



Source: Datastream

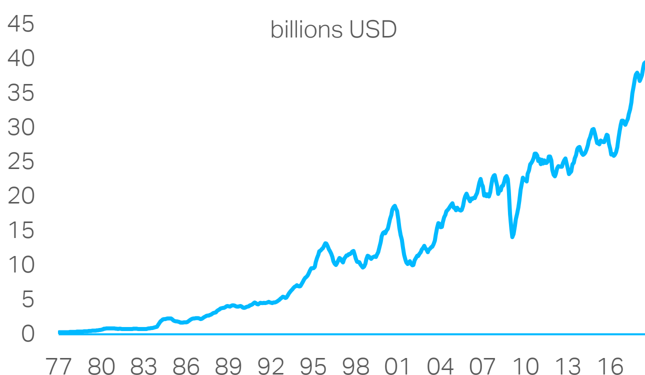
more exposed to China's bi-polar macro policies than the US, reflecting the region's continued over-reliance on external demand. Euro-area exports to China were up 20% YoY in mid-2017 – they are now stagnant. Europe has lost one of its growth catalysts.

China and Europe are also more vulnerable to trade-war anxiety, given their large export exposure and the fact many investors seem to share Donald Trump's view that America will "win". It is difficult to know to what degree trade tensions are currently weighing on business confidence and investment, but this appears to be a stronger story outside the United States. If you're a large exporter in Germany, it would make sense to delay any capex decision and wait for the situation to become clearer. After all, it is difficult to judge future demand and profitability, which makes it hard to work out whether such expenditures are worthwhile. Fortunately, the global tech sector is one area that appears to be holding up rather better than the bears were predicting. There has been no crash in the semi-conductor industry, despite astonishing growth in 2016/17. Global shipments are up almost 20% YoY and despite talk of saturation in the smartphone industry, we have now entered the time of the year where new product designs provide a powerful seasonal boost. Apple has just released the IPhone XS.

So it is fair to say global macro data have disappointed both the bulls and the bears in 2018. The world economy has been soggier and patchier than it was in 2017, but there is nothing to suggest a recession is now imminent. Most of the investors we talk to are still looking for signs that the current cycle is reaching its climax but classic late-cycle markers remain somewhat allusive (such as rising inflation, falling profits, over-investment, aggressive policy tightening). Of course, with slower global growth, the risk of recession naturally rises, but one doesn't automatically follow from the other. Trump's stimulus will disappear in 2018, but the Chinese will probably move in the opposite direction (again), easing policy and reflating the world. Since this leaves a rather dull and uninspiring global outlook, it is lucky we have a US administration intent on livening things up a little. We think a serious trade war is a much bigger risk than financial markets realize, which also means it is now the main threat to the global economic outlook.

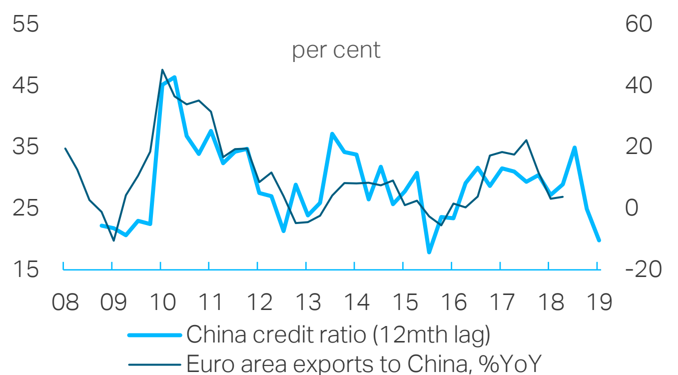
Naturally we will keep watching the data, but a serious escalation in the trade war would hit equities long before it showed up in official statistics. And now we must also keep an eye on the oil price, which continues to grind higher. Rising oil prices could eventually sap US real incomes, undermining the world's consumer of first and last resort. Nobody wants to see the world gravitate from synchronized boom, through US outperformance, to synchronized dimming.

Global semi-conductor billings



Source: Semiconductor Industry Association

China tightening hurts Europe



Source: TS Lombard