Talking Points

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Synchronized Global Economy: The Dark Side of the Boom

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Barely six months ago, many observers were marvelling at the synchronized global upswing. Things have changed. First, we saw **separation**, between advanced and emerging economies, and even between some advanced economies. More recently, it seems like almost every major economy in the world is dealing with some sort of **meaningful adversity or sour economic news**—and this week saw that in spades. And, accordingly, markets largely handed back last week's gains, bond yields sagged again, and commodities softened almost across the board. Here is a quick recap of what some of the largest economies faced just this week:

Germany: GDP fell at a 0.8% annual rate in Q3, pulling the year-on-year pace down to a mere 1.2% clip. True, there were some specific factors weighing on the quarter, which may be partially reversed in Q4, but the Euro Area overall has cooled to a 1.7% y/y growth rate from 2.7% as recently as the end of 2017.

Japan: GDP also fell at a 1.2% annual rate in Q3, pulling down the year-on-year pace to a mere 0.4% clip (a year ago it was running at 2.0% y/y). True, there were some special factors involved here too, which may also be partly reversed in Q4, but Japan is now on track to grow by less than 1% both this year and next.

UK: Brexit turmoil. Need I say more? (If you answered *"Why, yes"*, please see this week's Focus publication.)

Italy: The budget standoff with the EU continues, with Italy giving only a centimetre with a pledge to increase asset sales to contain debt. Meanwhile, back at the economy, Italian GDP eked out a 0.1% annualized rise in Q3, but is up just 0.8% y/y (down almost a point from a year ago).

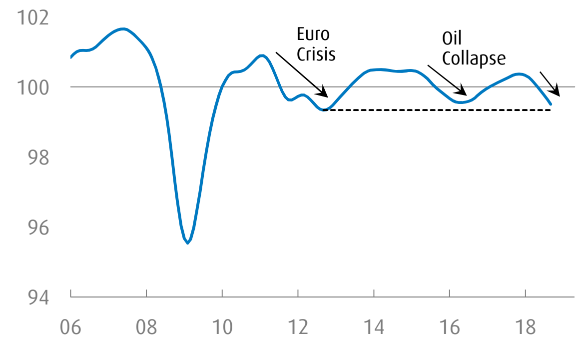
China: The economy is grappling with the ongoing trade tiff with the U.S., a full-on bear market in domestic stocks, and a currency that is off nearly 10% since the spring. The CSI did recover 2.8% this week, but is still down a hefty 24% this year in US$ terms. Industrial production managed to slightly beat expectations last month at a 5.9% y/y pace, but retail sales cooled to an 8.4% pace. While still undeniably solid, sales are on track for their slowest growth rate in 15 years in 2018. Vehicle sales are on course to drop this year, after a multi-year era of rip-roaring gains (although still close to 24 million units, by far the largest market in the world).

Mexico: The Banco de Mexico hiked 25 bps, taking the overnight rate to 8%, partly in response to the big drop in the peso in recent weeks. The Monetary Policy Statement took an unvarnished swipe at the incoming Administration, blaming the peso's weakness on the cancelled airport and on the market's *"concerns regarding both the incoming administration's policies and some legislative initiatives"*. And, the central bank would like to see *"measures to foster greater productivity and an environment of confidence and certainty for investors are adopted, public finances are consolidated sustainably, and both transparency and accountability of public*

policies are strengthened." Since the Fed began hiking in late 2015, Mexico has now raised short-term rates by a whopping 500 bps, versus the leisurely 200 bps from the Fed.

Chart 1
Past the Best Before

Advanced Economies
OECD Leading Indicator



Sources: BMO Economics, Haver Analytics

Canada: The economy is now facing intense new pressure from the deeper drop in global oil prices—even with a recovery in the second half of the week after a record 12-day losing skid, they still fell more than 5% this week. This broader sag is loaded on top of the historically wide discount on WCS, with the latter dropping even below levels hit during the depths of the oil shock in 2016. (See this week's Feature Article in *Focus* for the economic and financial market implications of sustained weakness.) If that wasn't enough to deal with, there's now even a flicker of concern about the fate of the USMCA in Congress, with the Democrats in control of the House. The good news is that Dems don't necessarily want to re-open the text, and are looking more at strengthening U.S. rules. The bad news is that there may yet be some drama; and, at the very least, the uncertainty could be prolonged. Despite the double-barrel of challenging news, the Canadian dollar managed to firm modestly on the week.

France: Apparently not content to be left out of the downbeat news, France somehow managed to get into a slagging match with the U.S. President. The latter even renewed a threat to slap tariffs on autos. Of course, there's the small matter that France doesn't even make it to the top 15 countries that the U.S. imports autos from, falling behind such heavyweights as Slovakia, Finland and Turkey. But much like the rest of the EU, France has seen its GDP growth rate stumble to a modest 1.5% y/y pace in Q3 from 2.8% at the end of last year.

U.S.: Among the largest economies in the world, the U.S. does stand out as keeping its head well above water (along with perhaps India and Australia). The domestic economic news this week was still solid, with retail sales firm in October, inflation contained, and confidence still broadly running high. And, thus, it's no coincidence that U.S. equities are among the few that are clinging to small gains for 2018, even with a moderate pullback this week. Still, there's the issue that much of the hearty economic backdrop this year has been fuelled by fiscal stimulus; the budget deficit topped $100 billion in the first month of the new fiscal year, and has totalled over $800 billion in the past 12 months (and well on its way to $1 trillion for the full year ahead). Suffice it to say that we may be in store for some fiscal drama in 2019 with a split Congress.

Capturing these various signs of economic stress and financial market strain in one neat package is **the OECD leading indicator** (*Chart 1*). The latest results, released earlier this week, show that the index dipped further to the lowest level since 2012 (or near the height of the Euro crisis). It also marks a swift reversal from the strong readings reached near the end of last year, portending cooler global growth ahead. There are a few things to point out:

1. The data only take us up to September—i.e., before the correction in equity markets. (Yes, these leading indicators are a bit… umm… lagged.)

2. On a brighter note, we have seen two similar dips in the index which were eventually reversed in this cycle alone, so the moderate downdraft so far does not alone signal the end of the expansion.

3. Digging beneath the broad indicator, there are quite different trends among some of the major economies, with the U.S. (not surprisingly) holding up better than many others.

Lest we leave with the impression that global growth is heading into the tank, note that **world GDP is still on track for a 3.6% advance this year**, barely down from last year's solid 3.7% clip. And for 2019, we are looking at 3.4%, a respectable showing. However, it is clear that the upswing has passed its peak, growth will be a bit below average next year, and the risks are tilted to the low side of the official call, not the high side. We may get a big hint in how these risks unfold in just the next few weeks; each of the wild cards of US/China trade, Brexit, Italy's budget standoff, and the direction of global oil prices are approaching key hurdles within weeks.

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