Global economy in charts

Ian Stewart, Debapratim De, Rebecca Porter & Tom Simmons
Economics & Markets Research, Deloitte, London | Charts as on 25th Oct 2018
Our summary of the global economy *

• Developed economy GDP growth to decelerate \(^{(3)}\)
• Growing headwinds from protectionism \(^{(15, 18)}\)
• Emerging market stress rising over trade fears and US monetary tightening \(^{(3, 8)}\)
• US growth has surprised on the upside; signs of softer euro area activity \(^{(6)}\)
• US monetary policy normalisation in third year; markets expect rate rises through 2019 \(^{(7)}\)
• Yields on US government bonds close to six-year high \(^{(14)}\)
• Despite Brexit, UK activity edges up from 2018 Q1 low \(^{(9, 10, 12)}\)
• We think tighter labour market + recent drop in inflation = upward pressure on wages and consumer spending power \(^{(11)}\)
• Betting odds from bookmaker PaddyPower imply 50% chance of a no-deal Brexit and 18% chance of Jeremy Corbyn succeeding Theresa May as PM \(^{(13)}\)

* As on 25\(^{th}\) October

Superscripts indicate slide numbers for charts explaining stated points
Steady growth in 2018

Developed economy growth expected to slow in 2019. US rate rises and protectionism main threats to global economy.

**GDP growth: Actual & IMF forecasts (%)**

<table>
<thead>
<tr>
<th></th>
<th>Pre-crisis trend</th>
<th>Post-crisis trend</th>
<th>2018</th>
<th>2019</th>
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</thead>
<tbody>
<tr>
<td>'98 – '07</td>
<td>2.7</td>
<td>1.7</td>
<td>2.4</td>
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<tr>
<td>'11 – '16</td>
<td>2.4</td>
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<tr>
<td>Advanced economies</td>
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<td>Emerging markets</td>
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<td>World</td>
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<td>3.6</td>
<td>3.7</td>
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</tbody>
</table>

Source: IMF World Economic Outlook, October 2018
Labour markets tightening in major advanced economies

G7 unemployment is running close to its lowest level in almost three decades. We see this as a sign of tighter labour markets and rising wage pressures.
Rising oil prices have pushed up inflation in advanced economies

The price of oil is up 69% since last summer, largely due to cuts in OPEC production and robust global demand. This has pushed G7 inflation up, which is now running close to its highest level in six years.

G7 economies are the US, Japan, Germany, France, the UK, Italy and Canada
Slowdown in euro area activity; strong US recovery continues

A strong US recovery is evident in the economic data with the US manufacturing PMI running close to its highest level in 14 years. By contrast, a cooling in euro area activity is reflected in Germany’s IfO Business Climate Index which is at an 18-month low.
US Fed’s monetary policy normalisation well underway

A stronger-than-expected recovery in the US means the Fed is well ahead of other developed market central banks in the process of raising rates from unprecedented lows and quantitative tightening. Markets expect this to continue through the rest of this year.

**Central bank interest rates**

<table>
<thead>
<tr>
<th>Year</th>
<th>US</th>
<th>UK</th>
<th>Euro area</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>2.25%</td>
<td>0.75%</td>
<td>0.00%*</td>
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<tr>
<td>Market expectations for end-2018 three-month rates</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>2.7%</td>
<td>0.9%</td>
<td>-0.3%</td>
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*Main refinancing fixed rate
Emerging market currencies point to rising stress

A strong US recovery and rising rates have bolstered the US dollar. In addition, concerns over the impact of rising US protectionism on emerging markets (EM) and capital outflows as the US Fed tightens policy have hit EM currencies. The yuan had its worst month on record in June while the Indian rupee is down 13% since the beginning of the year.
Modest acceleration in UK growth

UK growth accelerated to 0.4% in Q2 after a disappointing 0.1% in Q1, supported by a pickup in the services and construction sectors. Recent real economy data indicate a continued pickup in Q3.

UK GDP growth: Actual and forecast (% YoY)

Source: Economics & Markets Research, Deloitte, London
Weak UK consumer spending primary drag on growth

Weak sterling and the resultant rise in inflation have hit the UK consumer. Consumer spending grew at around the slowest pace in six years in Q2.

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**UK consumer spending**

% YOY

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Recent trend: 80’s recession, 90’s recession, Global financial crisis

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<tr>
<th>Consumer spending growth (%)</th>
<th>2.4</th>
<th>1.1</th>
<th>1.2</th>
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<tbody>
<tr>
<td>‘14 – ‘17 Forecast*</td>
<td>2018</td>
<td>2019</td>
<td></td>
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* Forecasts from Consensus Economics
But UK labour market tightening and fall in inflation support real income growth

A tighter UK labour market and recent falls in inflation should support consumer incomes and spending power. Latest data show nominal earnings rising at fastest pace in almost ten years.
Brexit and weak demand continue to weigh on corporate risk appetite

Our latest Deloitte CFO Survey shows that UK Chief Financial Officers rate Brexit as the biggest risk to their businesses. Corporate risk appetite remains subdued and CFOs maintain a defensive strategy stance, increasingly focussed on cost reduction and cash control.

Source: Deloitte CFO Survey, Q3 2018
Conservatives and Labour neck and neck in opinion polling

The Conservatives have opened up a narrow lead over Labour in recent opinion polling but the parties have been running neck and neck for most of this year. Bookmaker PaddyPower’s odds imply an 18% probability of Jeremy Corbyn being the next PM.

Source: YouGov polls as on 25th October
US monetary policy normalisation = rise in treasury yields and higher volatility

With the Fed normalising monetary policy, treasury yields have risen close to a six-year high. Higher yields create a more challenging environment for equities. Equity market volatility spiked in January and, more recently, in October, as markets expect further monetary tightening.

US 10-year Treasury yield

VIX volatility index

- Lehman crash
- Euro debt crisis
- US ratings downgrade
- China hard landing
- US monetary tightening fears

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Modest pickup in global trade threatened by trade tensions

Growth in global trade has remained weak since the financial crisis. Over the last two years, trade volumes picked up as the global recovery took hold. Recent data indicate a cooling as recent tariffs imposed by the US and retaliation by Europe and China weigh on trade.
Crude best performing asset; rotation out of EM equities and treasuries

Crude oil is the best performing asset in our basket, up 14% as OPEC cut production this year. As Western central banks raise rates, US treasuries and German bunds have sold off. Rising rates in the West and US protectionism have hit emerging market equities, and with European growth slowing, European equities have also sold off.
Return of European country risk

Investors treated the euro area as a relatively homogeneous entity as evidenced by the convergence of Italian and German bond yields after the creation of the euro. The sovereign debt crisis in Europe saw the return of country risk and yields diverge. The continued spread between Italian and German bonds highlights that markets continue to see significant country risk.
Premature monetary tightening and rising protectionism top risks to global growth

The economics team’s subjective assessment of the likelihood of occurrence and potential impact of the top three risks facing the global and UK economies today.

**Risks to global economy**
- **No-deal Brexit**: Low probability, high potential impact.
- **Trade war with tariffs on >20% of global exports**: High probability, low potential impact.
- **Aggressive monetary tightening**: High probability, low potential impact.

**Risks to UK economy**
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Source: Economics & Markets Research, Deloitte, London
GDP growth in major economies: Actual & IMF forecasts

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Source: IMF World Economic Outlook, October 2018
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