Cazenove Capital

Economic optimism through a global lens

Janet Mui
Global Economist

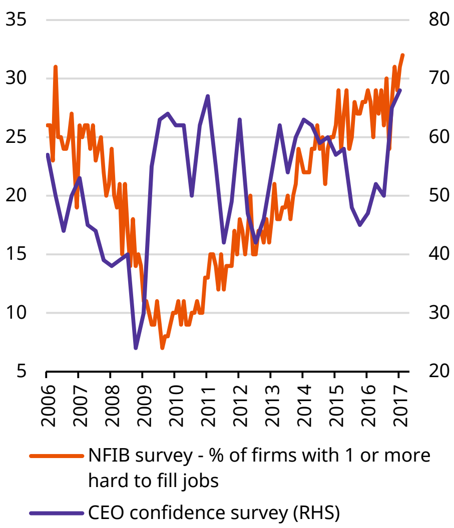
The International Monetary Fund (IMF) has revised up its 2017 world GDP growth projection from 3.4% to 3.5%, on the back of better than expected data from Europe, China and Japan, driven by broad-based recovery in trade and industrial activity. The encouraging feature is that growth in developing and advanced economies will both improve in 2017, for the first time since 2010.

US

Survey evidence relating to the performance of the US economy has been surprising to the upside since the presidential election last November. A distinguishing feature has been the rise in consumer and business confidence to the highest levels in a decade, which may be attributable to a revival of 'animal spirits' triggered by President Trump's proposed expansionary policies. However, it is noteworthy that that sentiment and survey-based information has been considerably stronger than actual activity data.

On the consumer side, retail sales values remain solid but no better than this, failing to breakthrough the 4% year-on-year trend. In addition, the trend in real personal expenditure is flat-lining due to higher prices. It suggests consumers, while being optimistic, are still waiting for more clarification before loosening their purse strings. The testing issue for US consumers this year will be higher inflation and policy disappointment.

US business confidence indicators



Source: Datastream

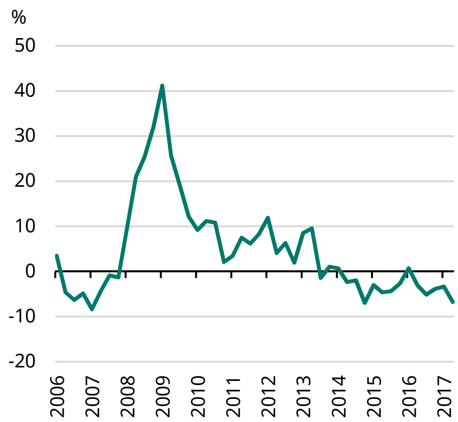
Overall, fundamentals remain moderately supportive vis-à-vis household consumption. The labour market tightened further in March, with the unemployment rate dipping to 4.5% from 4.7%, the lowest since April 2007. The unemployment rate has already fallen to the US Federal Reserve's projection for the fourth quarter of 2017 and is running below the neutral rate estimate of 4.7% – implying that faster wage growth should now be expected. Backing this view, the National Federation of Independent Businesses (NFIB) survey has suggested employers have been finding it increasingly difficult to fill job openings and are preparing to pay higher wages.

On the business side, the CEO confidence survey has picked-up and pointed to potentially stronger capital spending. The catalysts are the stronger growth outlook and President Trump's proposal to cut the main corporate tax rate from 35% to 15%. Although the tax reform proposals may not be passed in its full form, the combination of a pro-business White House and the Republican-controlled Congress will likely achieve some form of tax cut.

Eurozone

A major political risk for 2017 has now receded following the result of the first round of the French presidential election. Emmanuel Macron and Marine Le Pen are the finalists of the French presidential election, and polls (which have proven to be accurate) suggest the centrist candidate Macron will comfortably win the second-round vote on 7th May. With the tail-risk of an extremist French leader now receding, investors can finally move their focus from politics to growth.

ECB Bank Lending Survey Net change in credit standards to consumers last quarter



Source: Datastream

Improved economic momentum in the Eurozone has continued into the second quarter, with the Eurozone composite Purchasing Manager Index rising to its highest level in nearly six years. The pick-up in activity has been broad-based across key economies and sectors, with the weak euro and faster global growth supporting export activity. Germany, whose economy is highly export-oriented, enjoyed a strong first quarter, with industrial production, net trade and factory orders all exceeding expectations.

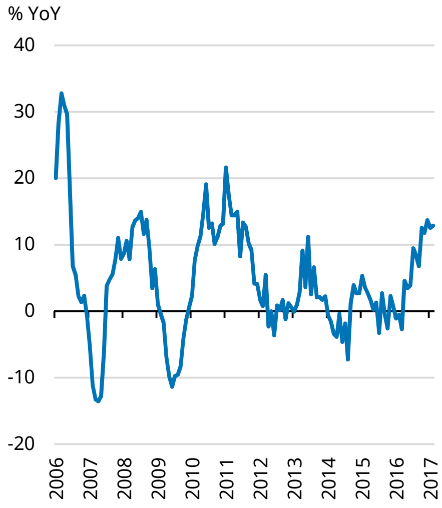
The European Central Bank lending survey for the first quarter of 2017 was largely positive. The survey showed easing lending conditions and increasing demand across all loan categories, pointing to a sustained pickup in credit growth. The conjunction of improving economic activity and a growing appetite to lend suggests that credit growth will continue to strengthen. This should help support a productivity enhancing recovery in capital spending.

UK

Following the announcement of a general election on June 8th, the UK will be the next to feature in the European political merry-go-round. The Conservative Party hopes to exploit its current 20-point opinion-poll lead over Labour to increase its majority in the House of Commons and strengthen its Brexit mandate. In addition, moving the date of the following general election, potentially to mid-2022, relieves some of the time pressure to complete a Brexit deal.

While the near-term growth impact of the approaching election is likely to be limited, momentum in the UK economy appears to have subsided. Official retail sales data for the first quarter disappointed markedly, confirming a slowdown in consumption growth as higher inflation depressed households' spending power. A spike in inflation and slower pay growth meant that regular real wage growth dipped to -0.1% YoY in March, and will possibly weaken further over the course of 2017. Slower real wage growth, less scope to deploy savings and a weak first quarter all point to lower contribution to overall GDP growth from household consumption in 2017. On a more positive note, there is little sign of a significant deterioration in UK consumer confidence, which suggests consumption is unlikely to fall precipitously.

UK exports of goods and services



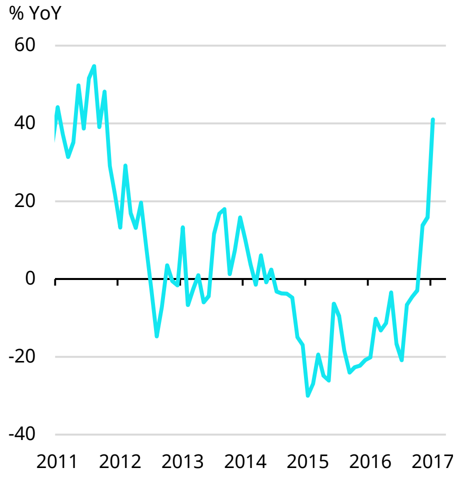
Source: Datastream

Despite the slowdown in household consumption, we expect the UK's growth mix to be more balanced in 2017, with more positive contributions coming from net trade and capital investment. There is evidence that exporters have benefited from previous weakness in sterling, as nominal export of goods and services rose 12.9% YoY in February, the best monthly increase since 2011.

Emerging markets

World trade volumes have recovered since mid-2016, expanding at about a 4% annual pace in first quarter of 2017, the best performance since late 2011. This has had a particularly positive impact on emerging economies, whose growth models are more geared toward exports and hence global trade. The pick up in EM exports was helped by higher commodity prices, improved purchasing power for commodity producers and better demand from advanced economies. The double-digit rise in Chinese imports undeniably had a major role to play in generating the improvement, especially in relation to exports from other Asian economies. This was attributable to the stimulus measures introduced in China and the subsequent construction boom which increased demand for imported materials and investment goods. On the flipside, the momentum in China construction may now slow due to tighter monetary and macro-prudential policy. Going forward, if we do see a pick-up in capital spending within advanced economies in 2017, the upturn in the trade cycle may be prolonged due to the trade-intensive nature of investment goods.

Emerging markets' exports to China



Source: Datastream

Cazenove Capital, 12 Moorgate, London, EC2R 6DA
T +44 (0)20 7658 1000 **F** +44 (0)20 7658 3827
cazenovecapital.com