Global economy faces triple shock

Hello, I'm Janet Henry, HSBC's Global Chief Economist.

The first half of 2018 has confirmed that the synchronised, accelerating expansion that we saw in most parts of the world in 2017 is now behind us. Divergence seems to be a better description of the global growth outlook for 2018. Our global growth forecasts are still pretty good; in fact, globally we look for growth this year to be more or less the same as in 2017. But only because of an acceleration in the US from 2.3 to 2.8 per cent, helped by a very hefty dose of fiscal stimulus. Elsewhere in the world, we are looking for a slowdown.

But what's also important is that the mood has started to shift, and the risks seem now to be skewed very much to the downside. There are numerous country-specific risks, many of them political. But actually what we focus on in this report is three major developments in the global economy which, if sustained or even escalated, could materially alter the outlook for the global economy. Now, all of these three are entirely, or at least partly driven by the US economy or changes in US policy. But many of the implications are most likely to be felt elsewhere in the world. Those three shocks are: the tightening in US financial conditions; higher oil prices; and, of course, the possibility of global trade wars.

On the first shock, the tightening in US financial conditions, this is actually long overdue for the US economy; equity markets are no longer rising, bond yields are higher and the US dollar seems to be appreciating. For some, like in Europe, a weaker euro is certainly quite helpful, particularly for the ECB. And if anything, our forecast for tightening in the G10 economies have been delayed a little bit later. But for some in the emerging world, particularly the deficit economies, it's led to some material changes to our forecasts for monetary policy. In fact in some cases, we've shifted from forecasting rate cuts to sizable rate increases, most spectacularly in Turkey and in Argentina.

But even in other more robust economies, we've also started to increase the amount of tightening that we're expecting; countries like India and the Philippines. Really, we are talking about countries of course, where they have high debt levels, they have current account deficits, they have a high exposure to foreign currency debt, and also countries which have a high foreign participation in bond markets.

Now the second shock, higher oil prices, is not just driven by US policy. Much of the rise over the last year has obviously been driven by a slowdown in oil supply, globally. But the latest rise since the start of the year, US policy has played a major role in that, particularly the decision by the US administration to re-impose sanctions on Iran. And again, some countries will be more influenced than others; some of the net oil importers, it will be a terms-of-trade shock, it may hit growth marginally, but it's not leading to a dramatic change in policy. But for some of those emerging economies, where their deficits are already deteriorating and their currencies have had a lot of depreciation, the impact on their domestic oil price has actually been a lot bigger, so it's an additional headache that they could do without, whereas in other emerging economies, where domestic demand is a bit stronger, again, it's an influence on the policy-setting.

And then the third shock, is clearly trade wars. So, over the last few weeks we've obviously had the retaliatory action coming through from some of the US allies to the steel and aluminium tariffs, particularly from Europe and from Canada. We've had the imposition of tariffs on China and we've got the threat of the imposition of tariffs on vehicles and auto parts, and the latter would certainly be a game-changer in terms of how worried we should be about the outlook for global trade when it is already starting to slow. In fact, if tariffs are imposed on all US imports of autos and other vehicles and of course, auto parts, they would amount to a bigger range, a bigger amount of products than all of the other tariffs imposed by the US administration.

But in terms of the overall impact on the US and indeed the global economy, much depends on how many of these tariffs are actually implemented, and actually the tariffs on autos could even come through before the US mid-term elections. But also, much of the channel of influence will be through the retaliatory action and the safeguard tariffs that might be announced by other countries, but also via asset markets and particularly investment intentions. Lots of uncertainty regarding supply chains, unpredictable trade policies coming through from a growing number of countries; this is where we are likely to see the greatest impact on growth the longer that risks continue to come through.

As for the US trade deficit, given our outlook of relatively robust growth in the US as many of its trading partners slow, and of course our view that the dollar is more likely to strengthen in the near term, we think that the trade deficit by the US economy is unlikely to materially start to shrink. In fact, we are forecasting an ongoing deficit.

So overall, looking at the global economy, the global growth numbers still look pretty healthy by post-crisis standards. But if many of these shocks continue to evolve, we will start to see greater headwinds on growth, and perhaps much of the story will start to be evident in 2019, when our growth forecasts already point to some softening in global growth, particularly as the initial impact of the US fiscal stimulus starts to fade.

Thank you.