



Economic Perspectives

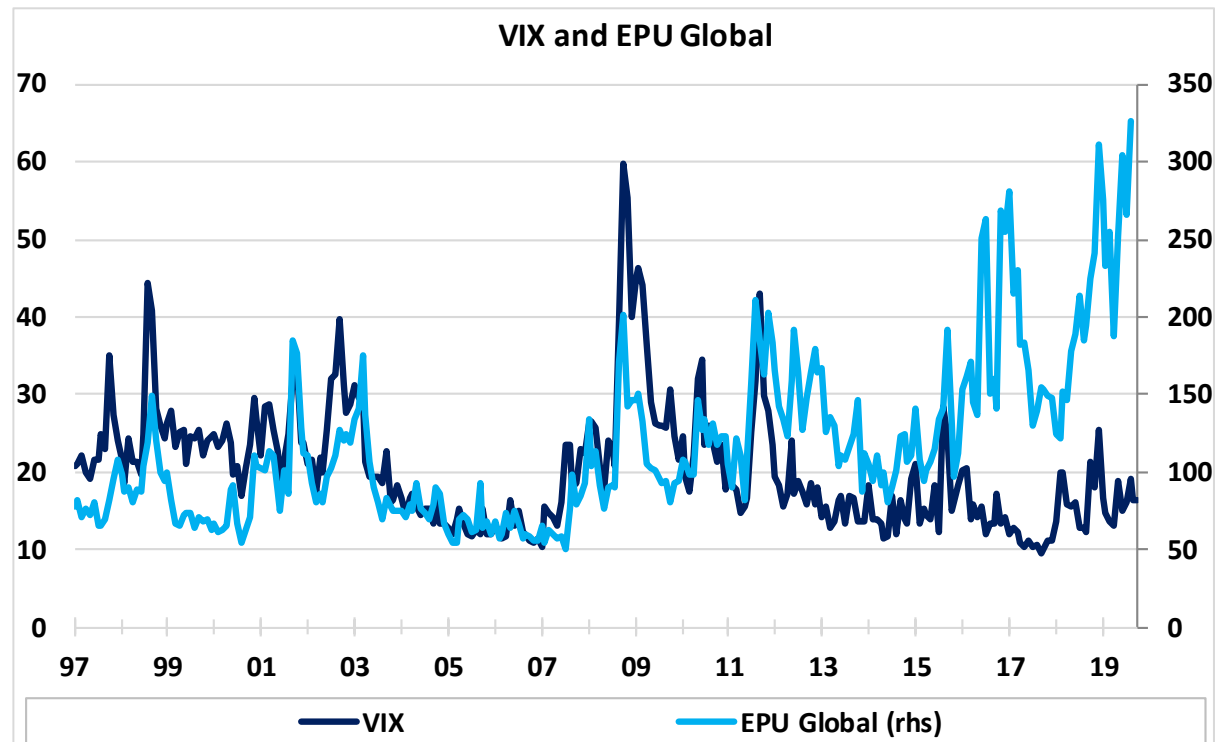
Dealing with higher uncertainty

Yvan Berthoux

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1. Divergence between volatility and uncertainty

- Three main factors have been associated to the global growth slowdown in the past two years: global monetary tightening, the contraction in Chinese credit impulse and the rise in uncertainty.
- Persistent divergence between fundamental volatility (Uncertainty) and price volatility (VIX) since 2016.

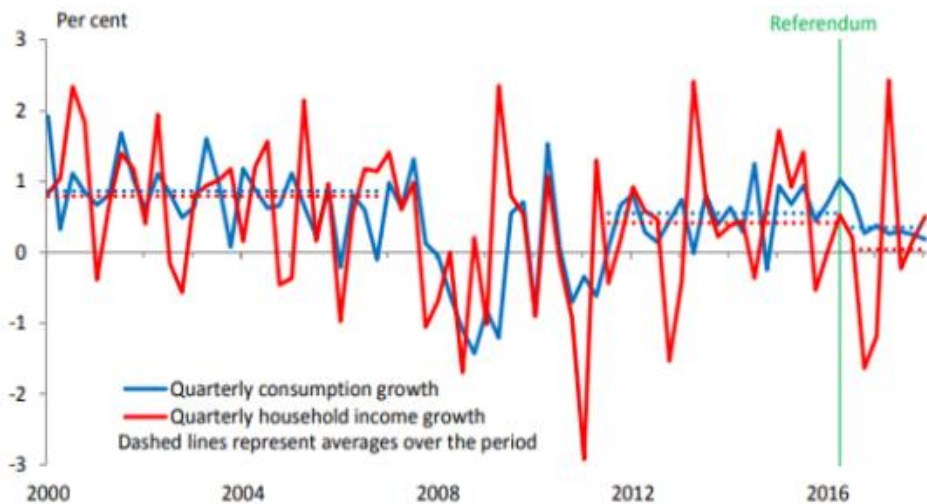


Date Source: Eikon Reuters, Baker et al. (2016)

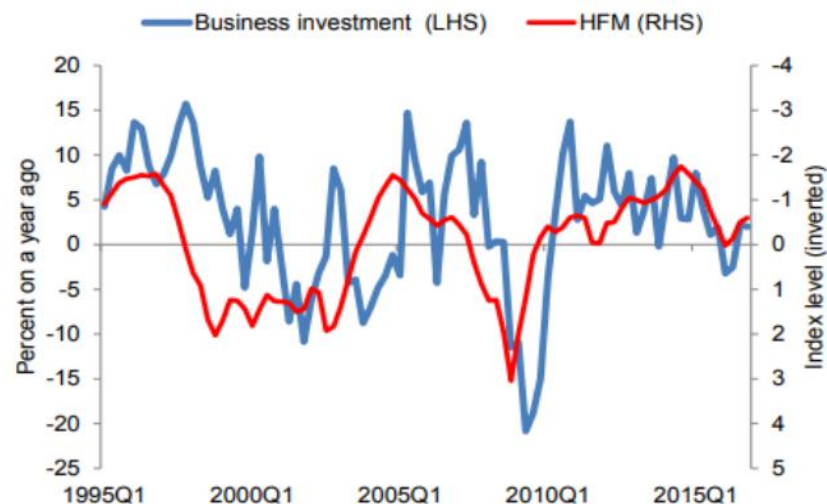
1. Higher uncertainty, lower consumption and investment

- Brexit has significantly reduced consumption growth and business investment in the UK.
- According to the Bank of England, consumption growth has slowed significantly: from 0.9% in the pre-crisis decade, to 0.6% in the 5 years preceding the referendum to 0.3% per quarter since Brexit.
- Empirical studies from the Bank of England found significant negative relationship between uncertainty and business investment.

Uncertainty reduces consumption growth



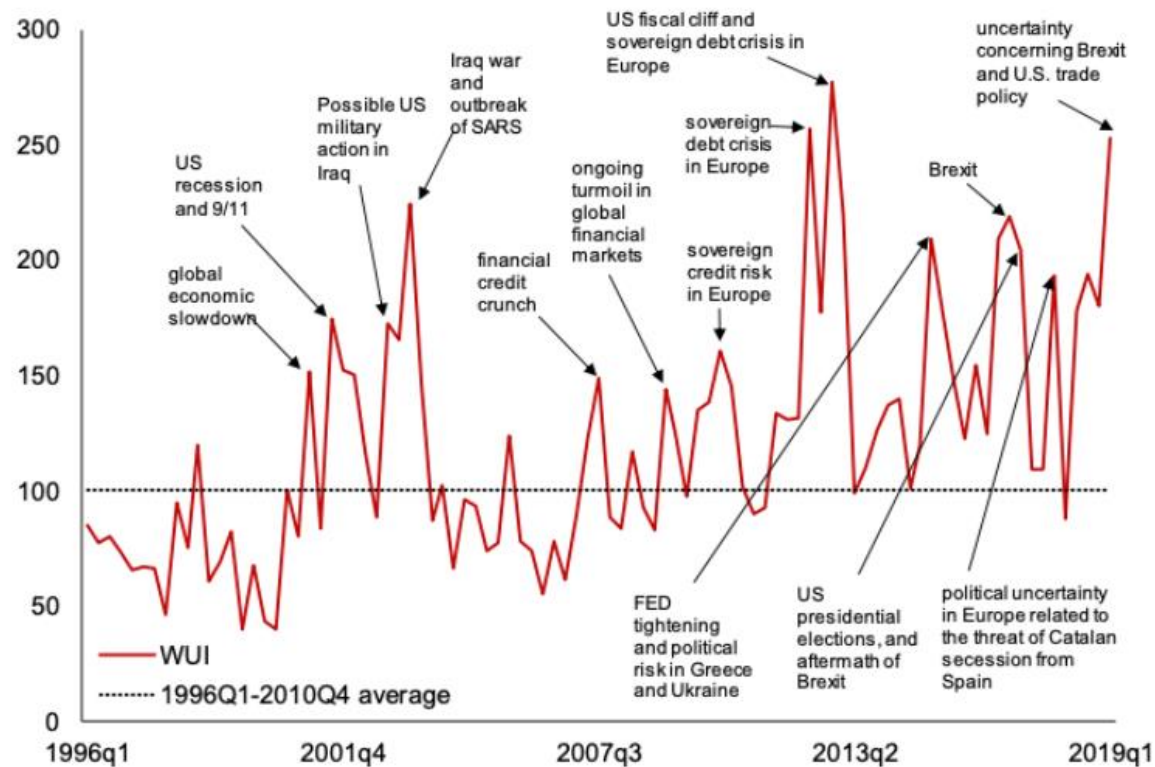
Uncertainty (red line) lowers business investment



Source: Bank of England

1. Rising uncertainty impacting global growth

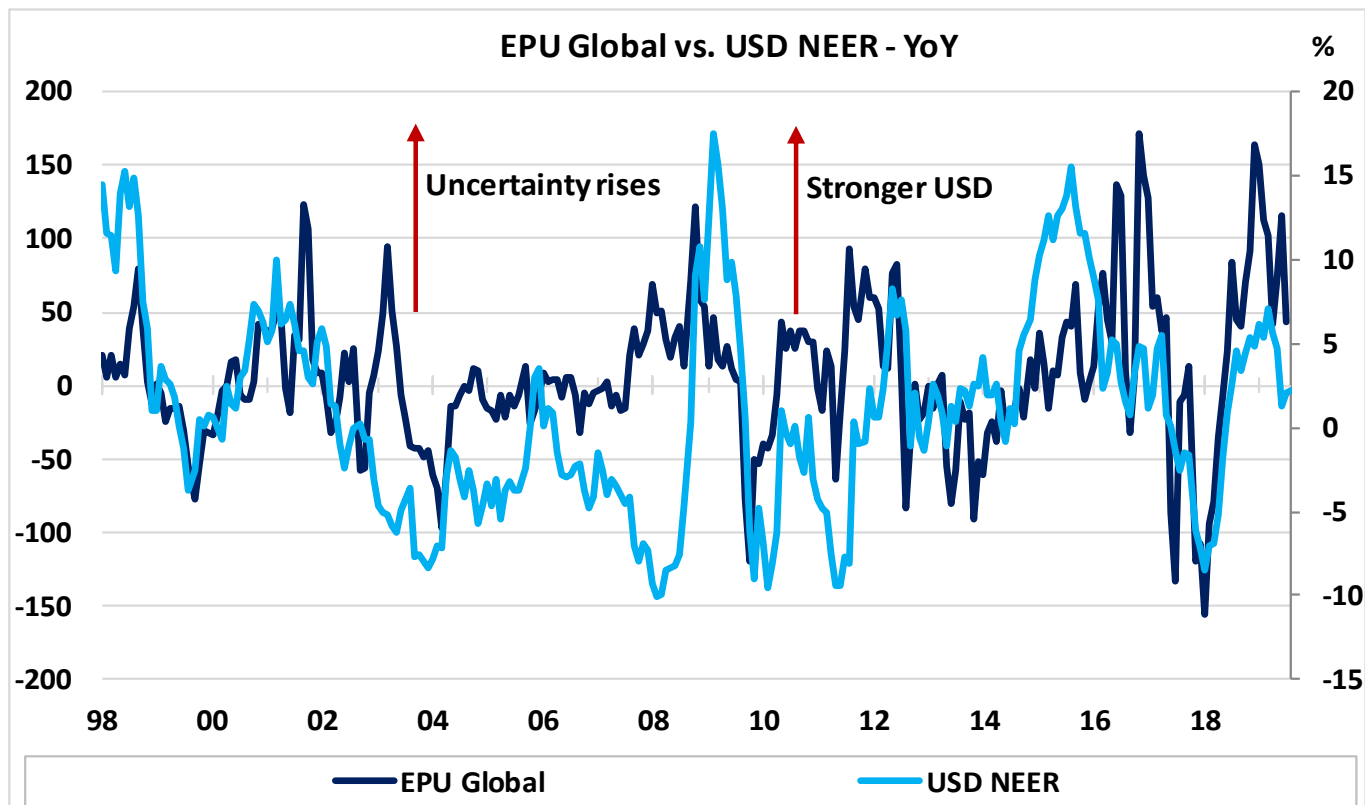
- In the past 18 months, uncertainty has been rising around the world: China-US trade war, in South Africa related to key policies or in Democratic Republic of Congo regarding the recent elections.
- Recent study from Ahir et al. (2019) found that the rise in uncertainty could knock out up to 75bps to 1% of global growth in 2019.



Source: Ahir et al. (2019)

1. Higher uncertainty, stronger US Dollar

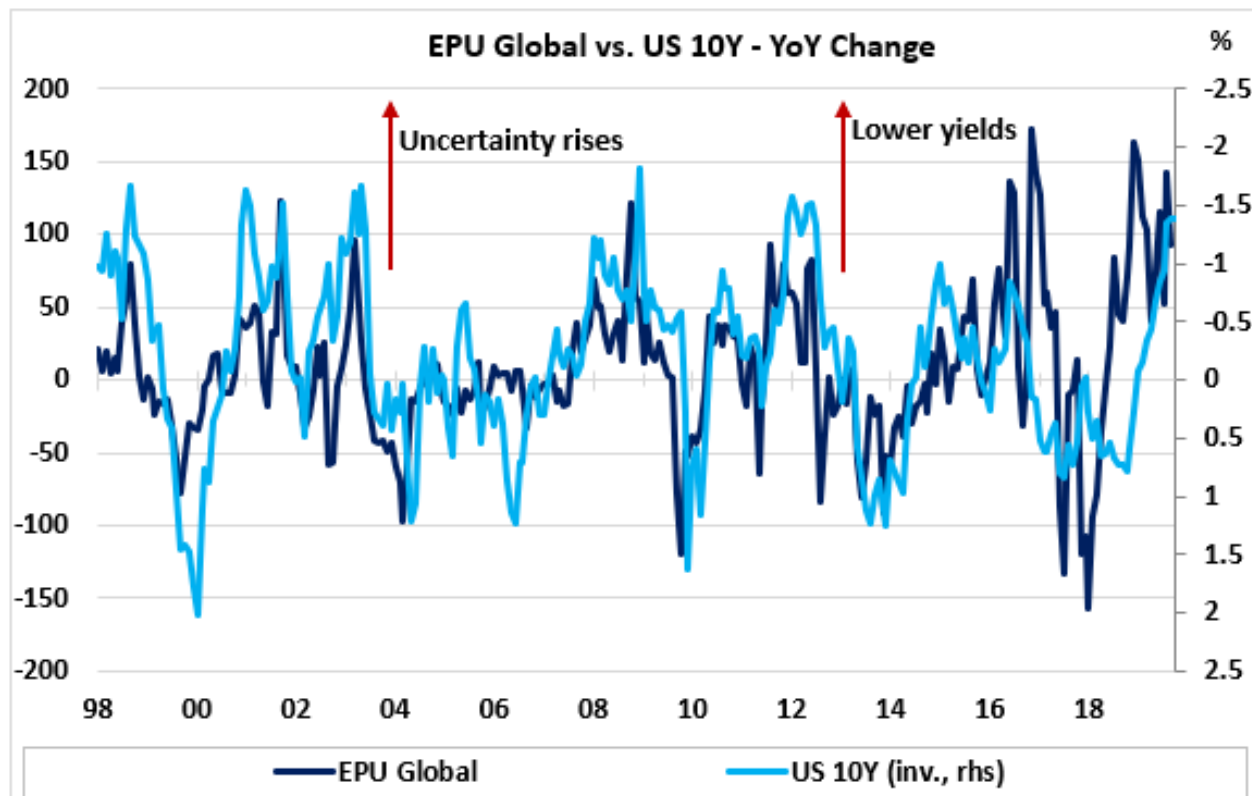
- We observe that the US Dollar tends to appreciate as uncertainty rises. The chart below shows the year-on-year change in the Economic Policy Uncertainty (EPU) index vs. the annual change in the broad USD index (NEER).
- USD can remain strong as long as global uncertainty persists.



Data source: Bloom et al. (2016), Eikon Reuters

1. Higher uncertainty, lower US yields

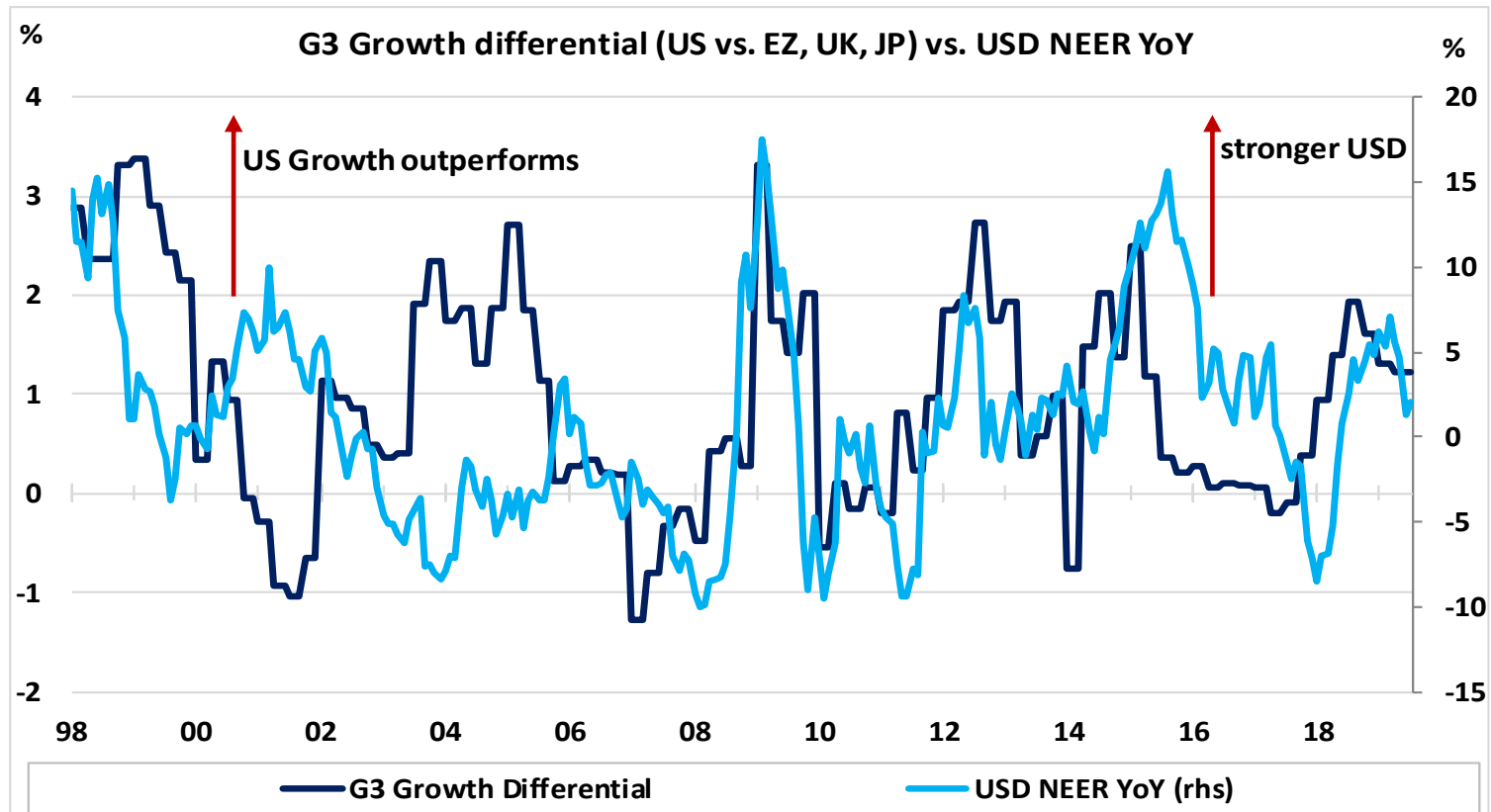
- In addition, we observe that the US yields tend to fall as uncertainty rises.
- The drop in the 10Y US Treasury yield occurred slightly after the dramatic rise in uncertainty we observed in 2018 / 2019.



Data source: Bloom et al. (2016), Eikon Reuters

1. Real growth differential vs. US Dollar

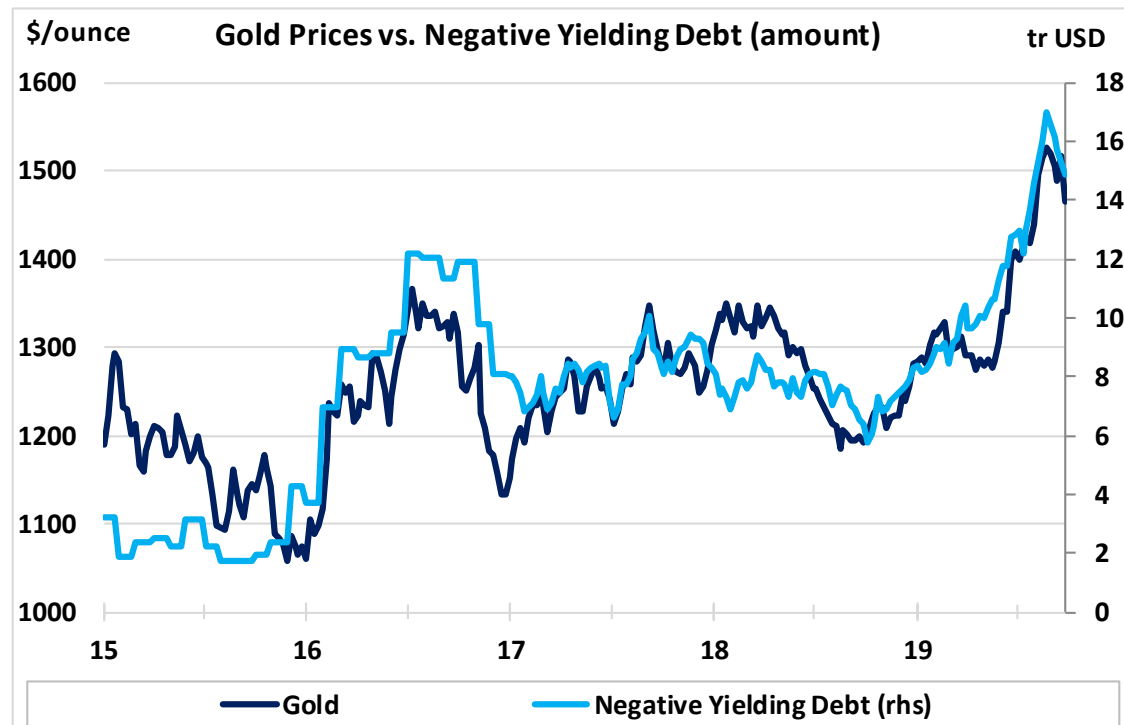
- Real growth differential has been a supportive influence for the US Dollar over time.
- Hence, as uncertainty has been impacting US real growth less significantly than the rest of the world, the outperformance of US growth relative to other major economies have been supporting the USD since the end of 2017.



Date Source: Eikon Reuters

1. Gold as a hedge against uncertainty

- Gold has had a variety of drivers over the decades: US Dollar, real interest rates, stock prices, central bank policies...
- Empirical research have argued that gold acts as a zero-beta asset and reduces losses in periods of extreme market shocks and is also offers protection against political and economic uncertainty.

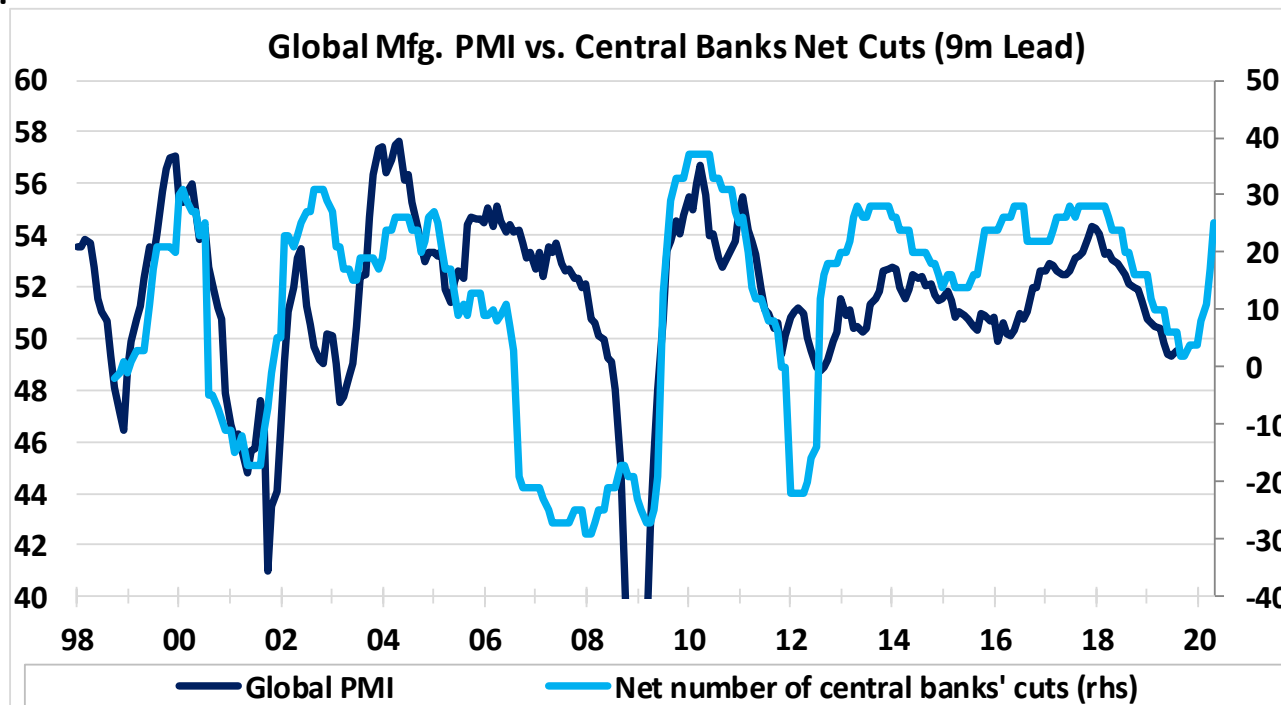


Date Source: Eikon Reuters, Bloomberg

2. Growth outlook to stabilize in 2020

(1)

- First, one of the main factors that contributed to the slowdown of the global economic activity has now reversed as central banks have been easing again.
- The recent sharp rise in rate cuts globally should send the PMI index back above the 50 threshold that notionally separates growth from contraction within the next 6 to 9 months.

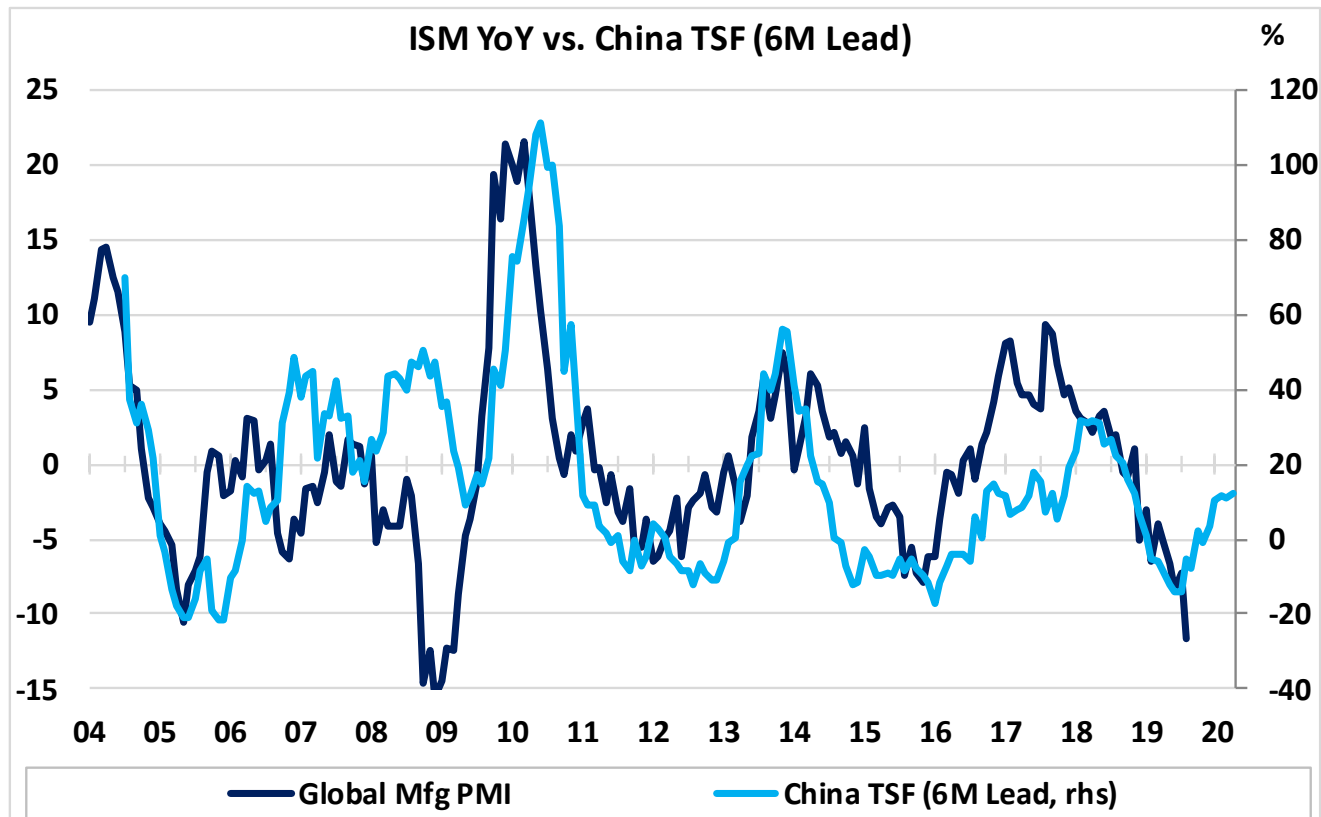


Date Source: Eikon Reuters, Bloomberg, EP calculations

2. Growth outlook to stabilize in 2020

(2)

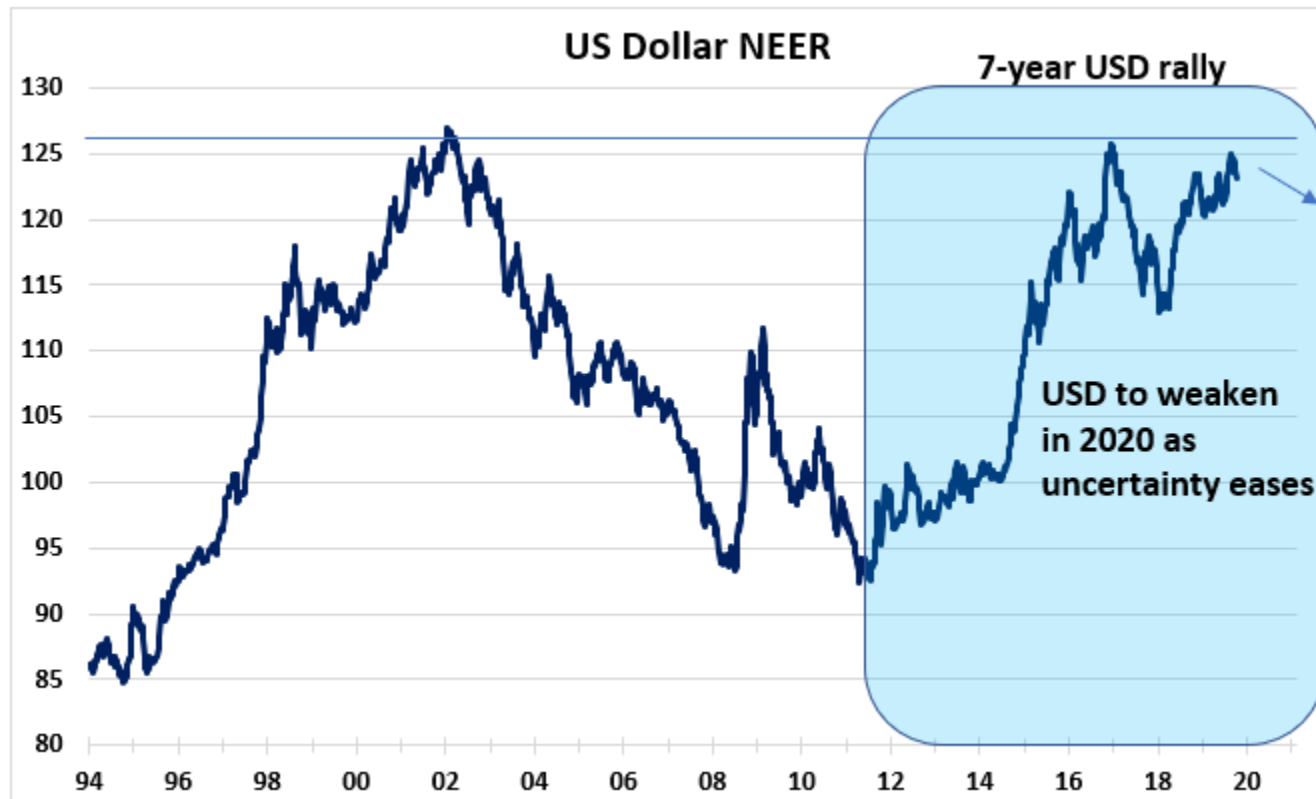
- Second, this year was also marked by a *significant* rebound in the Chinese credit impulse (Total Social Financing: TSF), which has also led to higher manufacturing PMIs globally.



Date Source: Eikon Reuters, Bloomberg

2. US Dollar to weaken as growth stabilizes

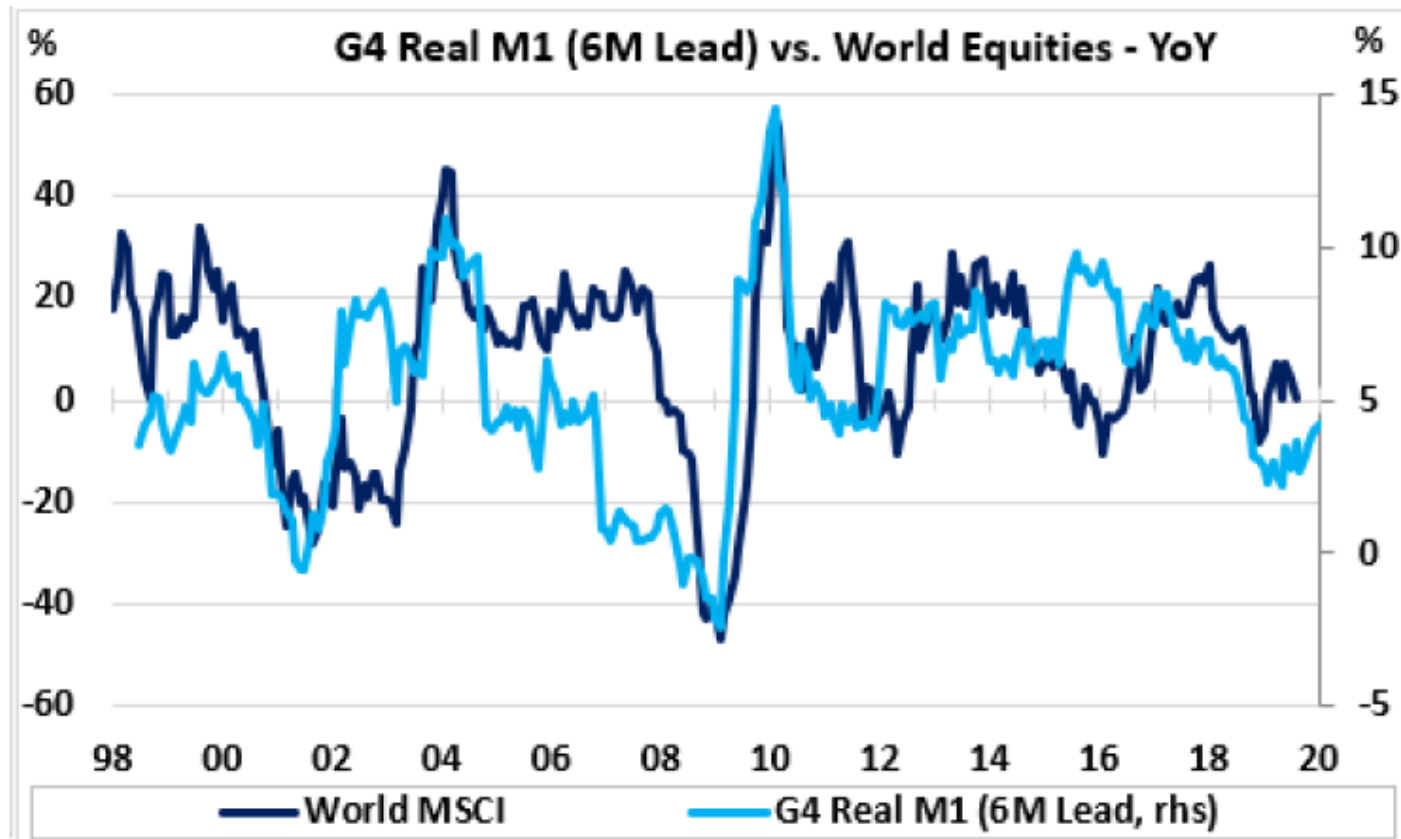
- As global growth stabilizes, we could see a prolonged period of USD weakness if uncertainty eases around the world.
- Candidates to offset that weakness: EUR, GBP.



Date Source: Eikon Reuters

2. Real M1 to pick up

- Real money growth seems to have bottomed in many countries, and therefore could lift up equities if uncertainty eases.
- Real M1 is traditionally seen as a leading liquidity indicators for stocks.

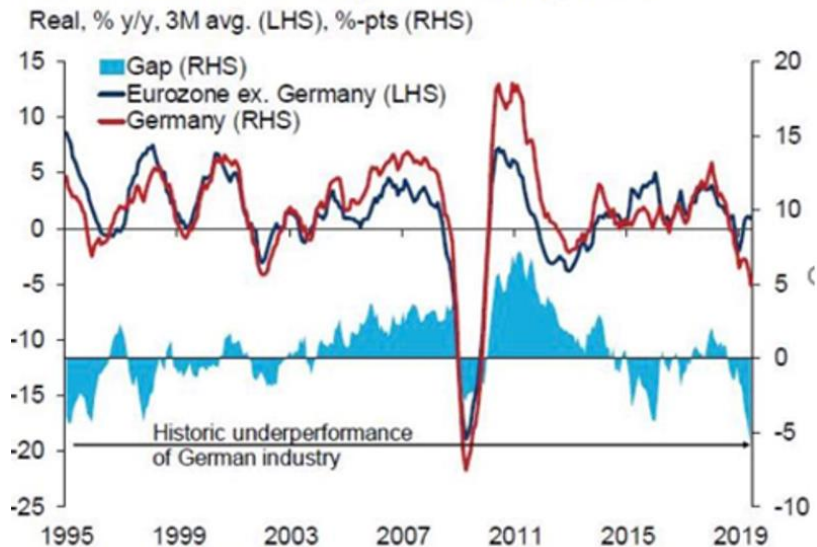


Data Source: Eikon Reuters, EP Calculations

2. Opportunities in Europe

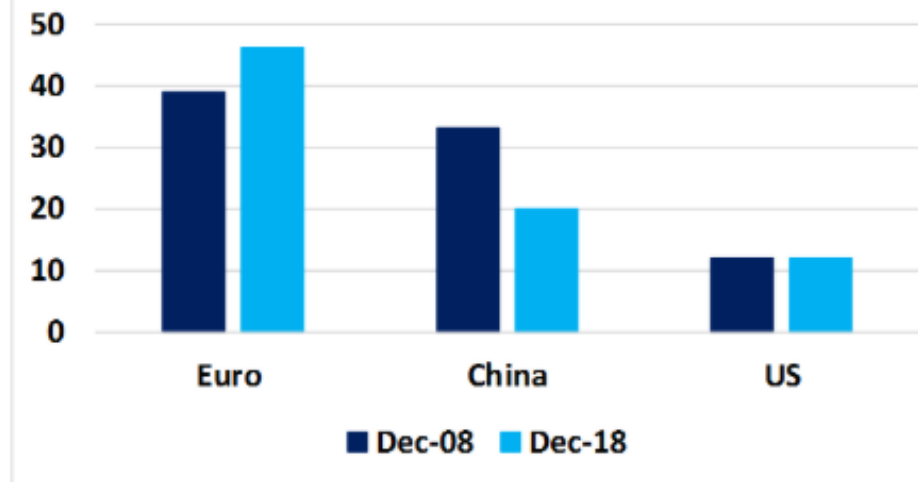
- The slowdown in Europe has been mainly driven by Germany; the industrial production differential has never been that extreme.
- However, German debt-to-GDP is only 61%, therefore can use fiscal stimulus to offset the current weakness.
- European equities could see a lift up in case fiscal conditions ease...

Eurozone: Industrial production growth



Source: Oxford Economics, OECD, BLS

Gross Export as a % of GDP



Conclusions

- Elevated uncertainty has eroded real growth expectations and enhanced the performance of supposed safe havens (Yen, Franc, gold and Treasuries).
- However, the reversal in global monetary policy combined with a potential ease in uncertainty in the beginning of 2020 should weaken the USD within the next 12 to 18M to come.
- Euro and Sterling remain favourable candidates to offset some of the USD weakness, both being significantly undervalued against the USD.



Economic Perspectives

Yvan Berthou

yvan@EconomicPerspectives.co.uk

+44 7715 565632

www.EconomicPerspectives.co.uk