Nouriel Roubini: A Mixed Economic Bag in 2019

Since the global synchronized growth of 2017, economic conditions have been gradually weakening and will produce an across-the-board deceleration in the months ahead. Beyond that, the prospect for markets and national economies will depend on a broad range of factors, some of which do not bode well, writes Nouriel Roubini

Slowdown but no recession

After the synchronized global economic expansion of 2017 came the asynchronous growth of 2018, when most countries other than the United States started to experience slowdowns. Worries about US inflation, the US Federal Reserve’s policy trajectory, ongoing trade wars, Italian budget and debt woes, China’s slowdown, and emerging-market fragilities led to a sharp fall in global equity markets toward the end of the year.

The good news at the start of 2019 is that the risk of an outright global recession is low. The bad news is that we are heading into a year of synchronized global deceleration; growth will fall toward – and, in some cases, below – potential in most regions.

To be sure, the year started with a rally in risky assets (US and global equities) after the bloodbath of the last quarter of 2018, when worries about Fed interest-rate hikes and about Chinese and US growth tanked many markets. Since then, the Fed has pivoted toward renewed dovishness, the US has maintained solid growth, and China’s macroeconomic easing has shown some promise of containing the slowdown there.

Whether these relatively positive conditions last will depend on many factors.

1. The first thing to consider is the Fed. Markets are now pricing in the Fed’s monetary-policy pause for the entire year, but the US labor market remains robust. Were wages to accelerate and produce even moderate inflation above 2%, fears of at least two more rate hikes this year would return, possibly shocking markets and leading to a tightening of financial conditions. That, in turn, will revive concerns about US growth.

2. Second, as the slowdown in China continues, the government’s current mix of modest monetary, credit, and fiscal stimulus could prove inadequate, given the lack of private-sector confidence and high levels of overcapacity and leverage. If worries about a Chinese slowdown resurface, markets could be severely affected. On the other hand, a stabilization of growth would duly renew market confidence.

3. A related factor is trade. While an escalation of the Sino-American conflict would hamper global growth, a continuation of the current truce via a deal on trade would reassure markets, even as the two countries’ geopolitical and technology rivalry continues to build over time.
Fourth, the eurozone is slowing down, and it remains to be seen whether it is heading toward lower potential growth or something worse. The outcome will be determined both by national-level variables – such as political developments in France, Italy, and Germany – and broader regional and global factors. Obviously, a “hard” Brexit would negatively affect business and investor confidence in the United Kingdom and the European Union alike.

US President Donald Trump extending his trade war to the European automotive sector would severely undercut growth across the EU, not just in Germany.

Finally, much will depend on how Euroseptic parties fare in the European Parliament elections this May. And that, in turn, will add to the uncertainties surrounding European Central Bank President Mario Draghi’s successor and the future of eurozone monetary policy.

Fifth, America’s dysfunctional domestic politics could add to uncertainties globally. The recent government shutdown suggests that every upcoming negotiation over the budget and the debt ceiling will turn into a partisan war of attrition. An expected report from the special counsel, Robert Mueller, may not lead to impeachment proceedings against Trump. And by the end of the year, the fiscal stimulus from the Republican tax cuts will become a fiscal drag, possibly weakening growth.

Sixth, equity markets in the US and elsewhere are still overvalued, even after the recent correction. As wage costs rise, weaker US earnings and profit margins in the coming months could be an unwelcome surprise. With highly indebted firms facing the possibility of rising short- and long-term borrowing costs, and with many tech stocks in need of further corrections, the danger of another risk-off episode and market correction can’t be ruled out.

Seventh, oil prices may be driven down by a coming supply glut, owing to shale production in the US, a potential regime change in Venezuela (leading to expectations of greater production over time), and failures by OPEC countries to cooperate with one another to constrain output. While low oil prices are good for consumers, they tend to weaken US stocks and markets in oil-exporting economies, raising concerns about corporate defaults in the energy and related sectors (as happened in early 2016).

Finally, the outlook for many emerging-market economies will depend on the aforementioned global uncertainties. The chief risks include slowdowns in the US or China, higher US inflation and a subsequent tightening by the Fed, trade wars, a stronger dollar, and falling oil and commodity prices.

Silver lining

Though there is a cloud over the global economy, the silver lining is that it has made the major central banks more dovish, starting with the Fed and the People’s Bank of China, and quickly followed by the European Central Bank, the Bank of England, the Bank of Japan, and others. Still, the fact that most central banks are in a highly accommodative position means that there is little room for additional monetary easing. And even if fiscal policy wasn’t constrained in most regions of the world, stimulus tends to come only after a growth stall is already underway, and usually with a significant lag.

There may be enough positive factors to make this a relatively decent, if mediocre, year for the global economy. But if some of the negative scenarios outlined above materialize, the synchronized slowdown of 2019 could lead to a global growth stall and sharp market downturn in 2020.

This article was published on Project Syndicate on 8 February 2019
Nouriel Roubini
Project Syndicate
Disclaimer

"THINK Outside" is a collection of specially selected content from sources that ING deems reliable, such as economic think-tanks and academic institutions, which ING Bank N.V. ("ING") uses to expand the range of independent opinions and sources you can find on the THINK website. Some of these sources are not the property of or managed by ING, and therefore ING cannot guarantee the correctness, completeness, actuality and quality of such sources, nor the availability at any given time of the data and information provided, and ING cannot accept any liability in this respect, insofar as this is permissible pursuant to the applicable laws and regulations.

This publication does not necessarily reflect the ING house view. This publication has been prepared solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved.

ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam).