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Summary

The world economy resilience over the last few months has surprised many forecasters but the incoming data from Europe this week coupled with a further climb in the price of oil suggest that downside risks are accumulating. In our charts this week we dig into this with some perspective on the downbeat messaging from September's sentix surveys (chart 1) and our calculations for credit impulses in the US and the euro area (chart 2). The potential for positive inflation surprises from the recent climb in the oil price is then explored in our next exhibit (chart 3). The offset to this, however, is the broader evidence of a post-pandemic re-balancing of the world economy (chart 4). Still, if the incoming growth data disappoint and inflation outcomes surprise to the upside financial markets are unlikely to react too positively (chart 5). The longer-term strength of that recovery and its dependency on productivity trends and demographic factors is then given some airtime (in chart 6).

Sentix surveys and data surprises

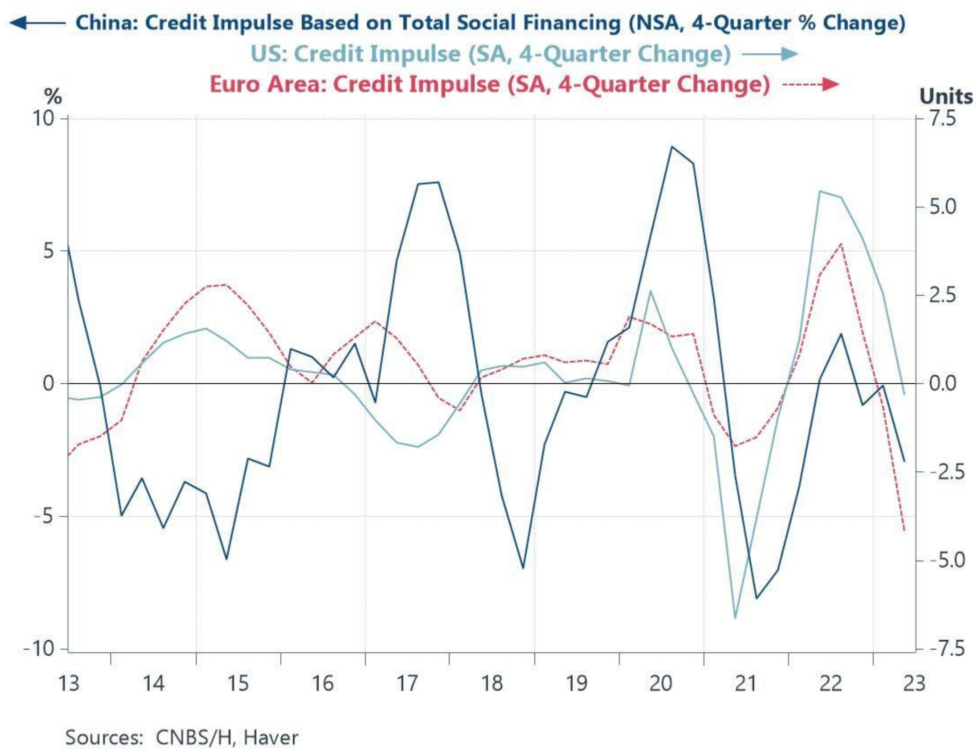
This week's regional sentix surveys for September danced in recession territory, particularly in the euro area. Broadly-based weakness in the headline and expectations components of these surveys chimed too with the weak messaging from August's purchasing managers surveys as well. As chart 1 below suggests, cyclical surveys such as these tend to do a good job at foreshadowing the evolution of the incoming economic data compared with expectations. As such they hint at a run of disappointing data in the period immediately ahead.

Chart 1: Negative investor expectations in the sentix survey often portend negative global growth surprises

Credit impulses in the US, euro area and China

One factor that is now arguably derailing the world economy with more force is tight monetary policy. Haver's calculations suggest the credit impulse in the US, euro area and China was negative based on the available data for 2023 H1. The synchronized nature of this credit contraction clearly does not bode well for the world economy in the period ahead.

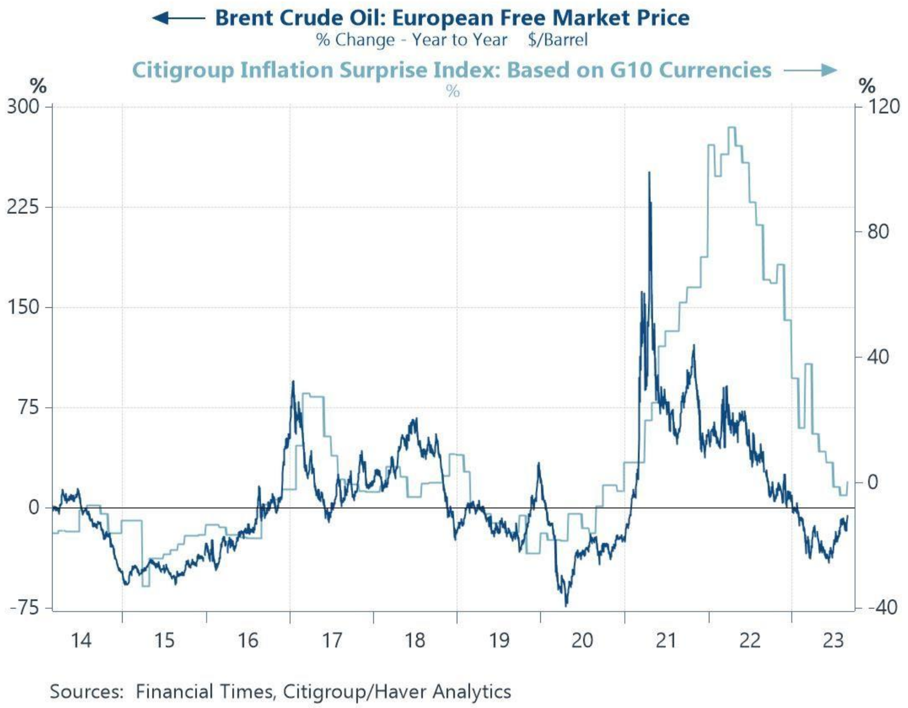
Chart 2: Credit impulses have turned negative in the US and euro area



Oil prices and inflation surprises

As noted, the increase in the price of oil in recent weeks is another potential negative hanging over the world economy. As chart 3 below suggests, oil price gyrations tend to foreshadow inflation surprises in the G10 economies. That increase in the oil price therefore potentially portends a run of positive inflation surprises in the weeks ahead.

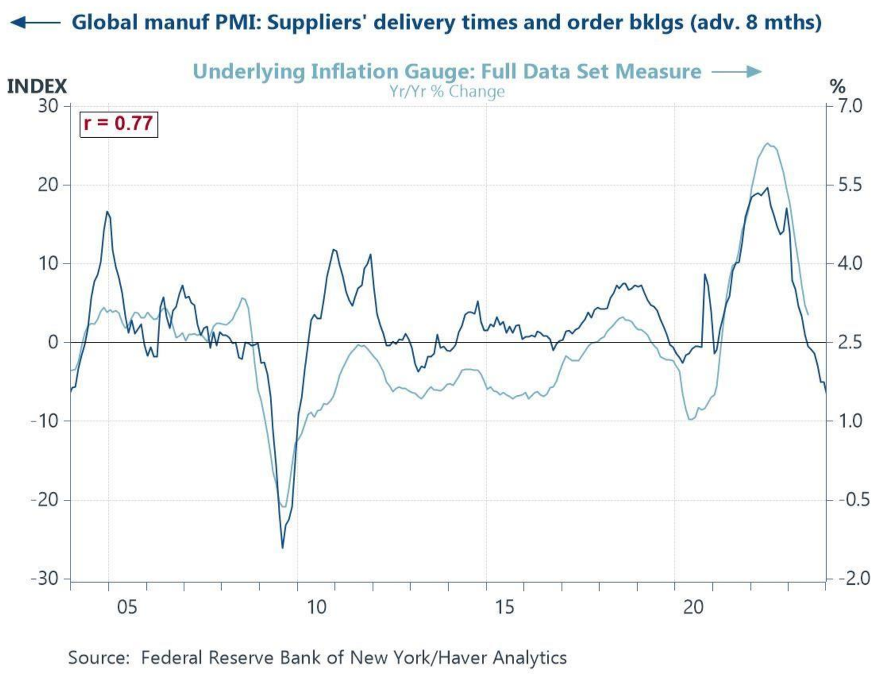
Chart 3: Inflation surprises in the G10 economies can often be traced to oil price gyrations



Manufacturing capacity pressures and underlying inflation

As also noted above, however, an important offset to this is the evidence for a re-balancing of demand and supply in the traded goods sectors. This can be seen in chart 4 via the normalisation of the supplier delivery times and order backlogs components in the global manufacturing PMI survey and how this has done a good job in recent years in foreshadowing underlying inflation in the United States.

Chart 4: Ebbing capacity pressures in US manufacturing bode well for underlying inflation pressures



Markets and data surprises

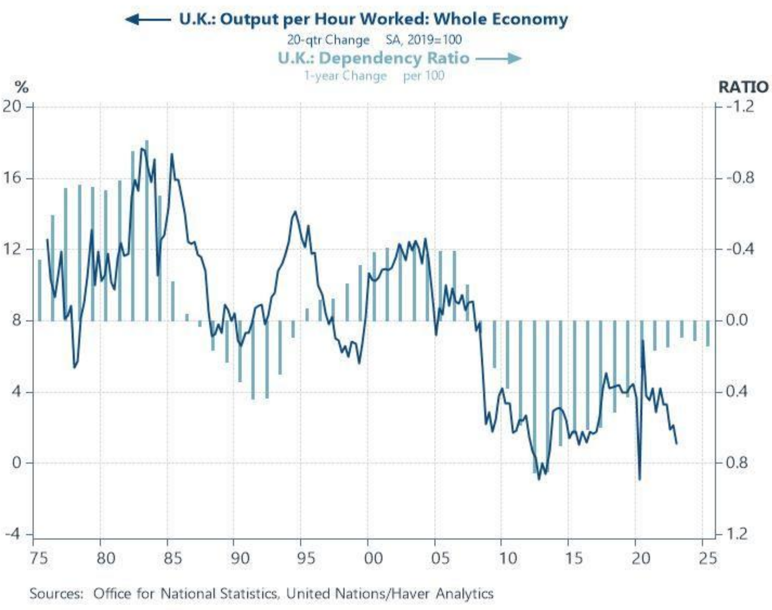
Still, if, as charts 1 -3 above suggest, the incoming data elicit more negative growth surprises and more positive inflation surprises that combination would be unlikely to be greeted positively by financial markets. This is the message from chart 5 below showing a tight correlation between Citigroup's surprise indices for growth and inflation in the G10 economies versus a global equity market index.

Chart 5: G10 growth and inflation surprises versus global equity markets

Demographics and productivity

From a much longer-term perspective, the evolution of the world economy (and financial markets) will hinge on slower-moving factors such as trend productivity growth and demographics. While narratives about the productivity-enhancing potential from artificial intelligence have been all the rage in investment circles of late there has, as yet, been little evidence to suggest that trend productivity growth is responding. A number of factors could be responsible for this including straightforward implementation lags. But empirically it may be of note that weaker trend productivity growth has tended to rhyme with demographic restraint in many major economies in recent years. This can be seen in chart 6 below showing the trend increase in the UK economy's dependency ratio – the ratio of the very old and the very young to the working age population - over recent decades (the data are inverted in the chart) against the 5 year change in the UK's labour productivity growth.

Chart 6: Ageing demographics may have placed a brake on UK productivity growth in recent years



ABOUT THE AUTHOR

Haver Analytics is pleased to bring Andrew Cates's commentaries on the state of the global economy to its clients.

Andy Cates has more than 25 years of experience forecasting the global economic outlook and in assessing the implications for policy settings and financial markets. He has held various senior positions in London in a number of Investment Banks including as Head of Developed Markets Economics at Nomura and as Chief Eurozone Economist at RBS. These followed a spell of 21 years as Senior International Economist at UBS, 5 of which were spent in Singapore. Prior to his time in financial services Andy was a UK economist at HM Treasury in London holding positions in the domestic forecasting and macroeconomic modelling units.

He has a BA in Economics from the University of York and an MSc in Economics and Econometrics from the University of Southampton.