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Written by Andy Cates

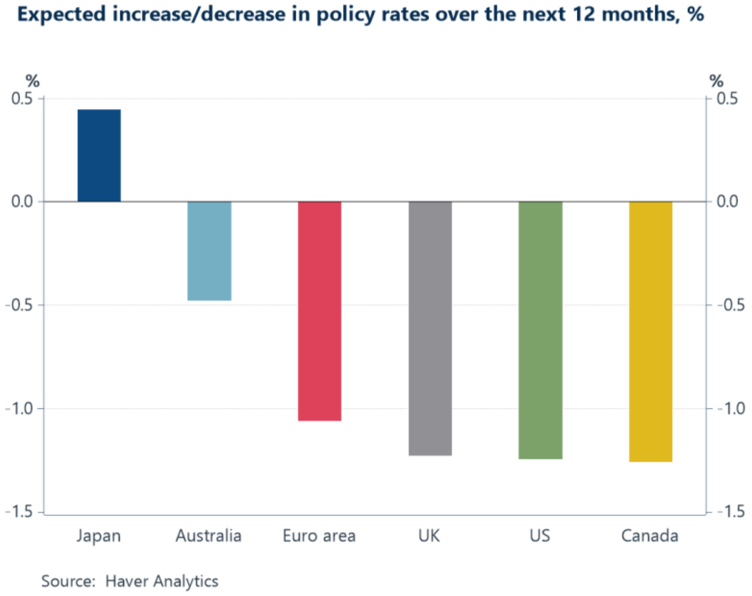
Geopolitical scarring

In recent weeks, financial markets have generally aligned with expectations of a soft landing for the global economy, facilitated by more accommodative policies from central banks (see chart 1). This week's dataflow have largely reinforced these views (see chart 2) as have the communications from many policymakers. However, the escalation of geopolitical turbulence in the Middle East in recent days is now challenging this narrative. By potentially choking supply chains and raising risk premiums in energy markets, there could be growth and inflation-related consequences for the world economy in the coming weeks (see charts 3). This also serves as a reminder that there are longer-term headwinds that are placing a brake on global growth at present, including high real energy prices (chart 4), de-globalization pressures (chart 5) and lingering debt-related imbalances (see chart 6). And many of these issues could be exacerbated if the turmoil in the Middle East were to intensify.

Policy rate expectations

Blue Chip panelists continue to forecast that policy rates in most major economies will decline sharply in coming months. The ECB, for example, is expected to lower its key policy rates by around 105 basis points over the next 12 months while the BoE is expected to lower its Bank rate by 125 bps over the same time frame. These forecasts contrast with the US where policy rates are expected to be lowered by 125 basis point between now and this time next year. The BoJ in the meantime continues to remain an outlier in this generic global trend with Japan's policy rate specifically expected to climb by 45bps over the next 12 months.

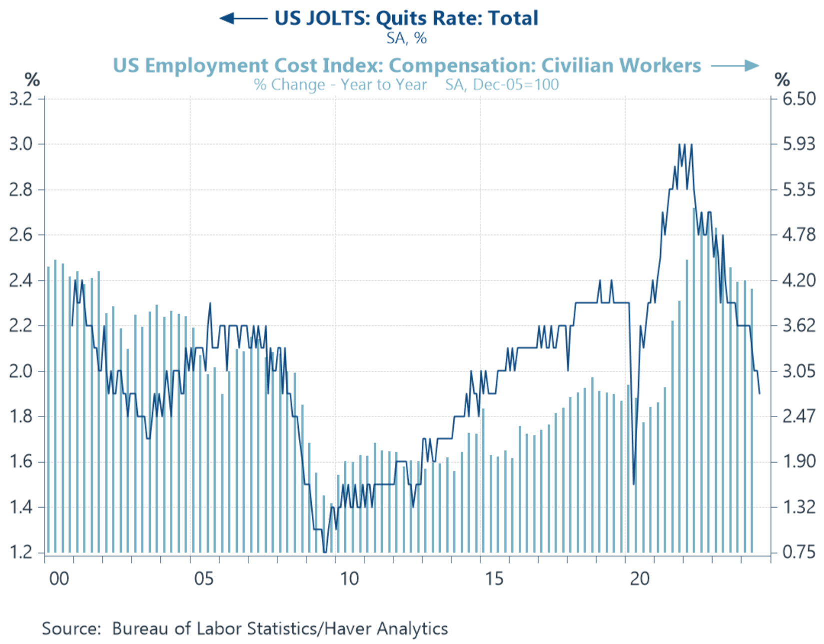
Chart 1: Blue Chip Financial Forecasts: Expected changes in policy rates over the next 12 months



The US labour market

Ahead of the payrolls data for September that are due later this week there have been some mixed messages on the state of the US labour market in recent days. September's ADP report concerning private sector employment, for example, was a little stronger than expected. On the weaker side, the latest Job Openings and Labour Turnover (JOLTS) survey revealed a steep decline in the number of people in the US workforce that have been quitting their jobs, a strong signal that the labour market is loosening. As chart 2 below suggests, that ought to additionally imply weaker wages pressures in the period ahead as well.

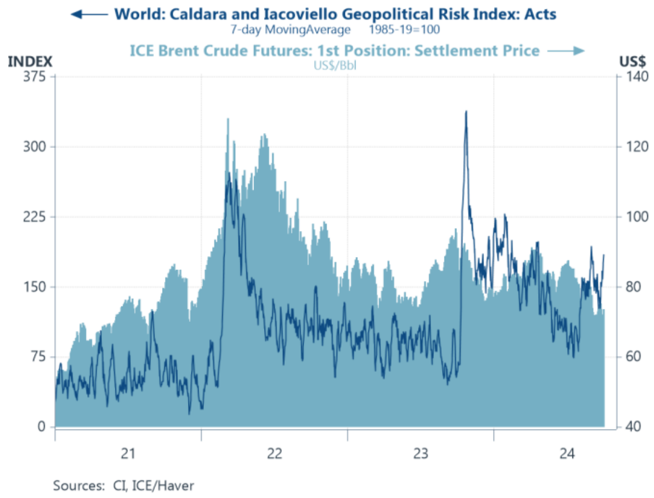
Chart 2: The US Quits Rate versus Wage Growth



Geopolitical risks and oil prices

Soft landing narratives have been aided by evidence suggesting that labour markets are cooling, that wage pressures are ebbing and that broader inflationary pressures are fading. But, as noted above, the escalation of geopolitical turbulence in the Middle East is now challenging these views. A widely watched gauge of geopolitical risks has bolted sharply higher in recent days off the heels of this turbulence, as evidenced in chart 3 below. And energy markets – oil prices in particular – appear to now be responding to this instability as well.

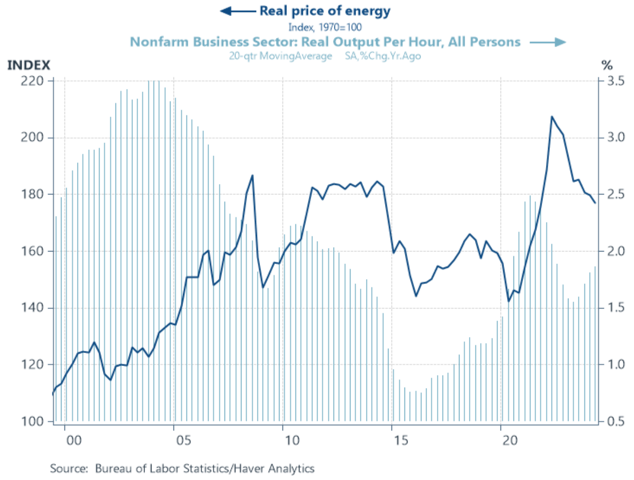
Chart 3: An index of geopolitical risk versus oil prices



The real consumer price of energy versus US productivity growth

It goes without saying that energy prices exert a powerful influence over the world economy. Aside from headline inflation linkages, high real energy prices have arguably been a key factor that's kept productivity growth in many major economies muted over the past few years. As chart 4 below indicates, longer-term upswings in US productivity growth have tended to be preceded by weaker real energy prices. Equally, longer-term downswings in productivity have typically followed periods when real energy prices have been rising.

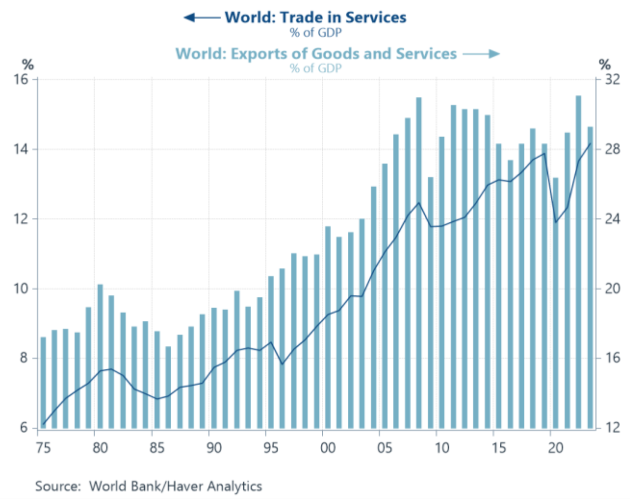
Chart 4: Real energy prices and US productivity growth



Globalisation versus de-globalisation

A further disruption of supply chains is also a looming threat to the world economy if the instability in the Middle East were to intensify. In the background to this, and thanks to several additional factors that have undermined world trade in recent years, a de-globalisation of the world economy has been unfolding. That said, latest data from the World Bank suggest we should not get too carried with that de-globalisation narrative. The level of world trade in services, for example, reached a record high in 2023.

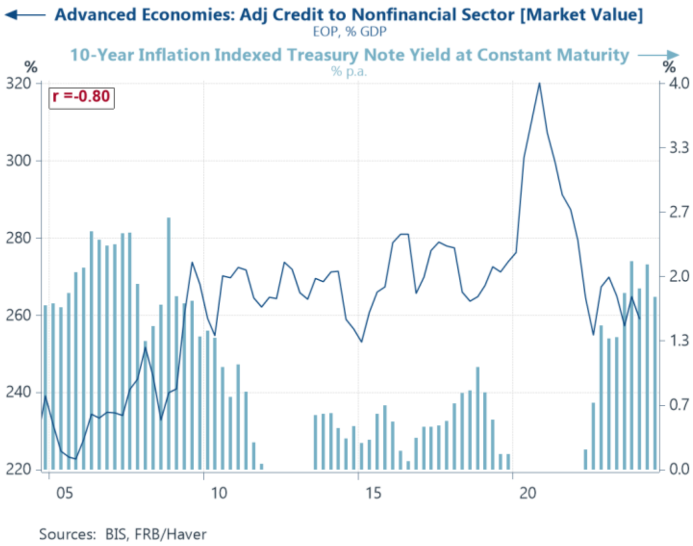
Chart 5: World trade in goods and services



Indebtedness and interest rates

There is no doubt that ongoing geopolitical instability, combined with other factors such as heightened protectionism, could accelerate a broader trend toward de-globalization in the coming period. This, along with other structural challenges such as high energy prices and ageing demographics, may be hindering long-term productivity growth. Offsetting factors do exist, most notably the productivity potential of Artificial Intelligence. However, until those offsets fully materialize, many policymakers are likely to again rely on monetary policy tools and other re-leveraging initiatives to boost economic growth to politically acceptable levels. The strong negative correlation between long-term US real interest rates and global indebtedness in chart 6 below highlights how these policy efforts have become central to maintaining economic stability, often at the expense of increasing financial vulnerabilities.

Chart 6: The credit to GDP ratio in advanced economies versus US real interest rates



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.

Data featured in this commentary:

Chart 1: Blue Chip Financial Forecasts: Expected changes in policy rates over the next 12 months

Series 1: (AAYW@BLUECFIN - N158RTAR@G10)
AAYW@BLUECFIN [BCFF: Japan: Policy-Rate Balance Rate 12-Mo Forecast: Consensus (%)]
N158RTAR@G10 [Japan: Bank of Japan Policy Rate (EOP, %)]
Series 2: (AAZI@BLUECFIN - N193RTAR@G10)
AAZI@BLUECFIN [BCFF: Australia: Official Cash Rate 12-Mo Forecast: Consensus (%)]
N193RTAR@G10 [Australia: Official Cash Rate (EOP, %)]
Series 3: (AAZL@BLUECFIN - I023MR@EUDATA)
AAZL@BLUECFIN [BCFF: Euro area: Main Refinancing Rate 12-Mo Forecast: Consensus (%)]
I023MR@EUDATA [Euro Area 11-20: Main Refinancing Rate (EOP, %)]
Series 4: (AAYZ@BLUECFIN - N112RTAR@G10)
AAYZ@BLUECFIN [BCFF: UK: Official Bank Rate 12-Mo Forecast: Consensus (%)]
N112RTAR@G10 [U.K.: Official Bank Rate (EOP, %)]
Series 5: (AAYQ@BLUECFIN - N111RTAR@G10)
AAYQ@BLUECFIN [BCFF: US: Fed Funds Target Rate 12-Mo Forecast: Consensus (%)]
N111RTAR@G10 [U.S.: Federal Open Market Committee: Fed Funds Target Rate (EOP, %)]
Series 6: (AAZF@BLUECFIN - N156RTAR@G10)
AAZF@BLUECFIN [BCFF: Canada: O/N Money Mkt Financing Rate 12-Mo Forecast: Consensus (%)]
N156RTAR@G10 [Canada: Overnight Money Market Financing Rate [Target] (EOP, %)]

Chart 2: The US Quits Rate versus Wage Growth

Series 1: LJQTPA@USECON
LJQTPA@USECON [JOLTS: Quits Rate: Total (SA, %)]
Series 2: yryr%(LS@USECON)
LS@USECON [Employment Cost Index: Compensation: Civilian Workers (SA, Dec-05=100)]

Chart 3: An index of geopolitical risk versus oil prices

Series 1: movv(DGLGPRA@ESG,7)
DGLGPRA@ESG [World: Caldara and Iacoviello Geopolitical Risk Index: Acts (1985-19=100)]
Series 2: PZBR01S@DAILY
PZBR01S@DAILY [ICE Brent Crude Futures: 1st Position: Settlement Price (US$/Bbl)]

Chart 4: Real energy prices and US productivity growth

Series 1: index((N003PCEN@OECDMEI / N003PCXG@OECDMEI),1970=100)
N003PCEN@OECDMEI [OECD Total: CPI: Energy [OECD Group] (NSA, 2015=100)][AGG=AVG, Default]
N003PCXG@OECDMEI [OECD Total: CPI: All Items excl Food and Energy [OECD Group] (NSA, 2015=100)][AGG=AVG, Default]
Series 2: movv(LXNFAPY@USECON,20)
LXNFAPY@USECON [Nonfarm Business Sector: Real Output Per Hour, All Persons (SA,%Chg.Yr.Ago)]

Chart 5: World trade in goods and services

Series 1: B001TSVP@WDI
B001TSVP@WDI [World: Trade in Services (% of GDP)]
Series 2: N001XGSP@WDI
N001XGSP@WDI [World: Exports of Goods and Services (% of GDP)]

Chart 6: The credit to GDP ratio in advanced economies versus US real interest rates

Series 1: S110CTZP@BIS
S110CTZP@BIS [Advanced Economies: Adj Credit to Nonfinancial Sector [Market Value](EOP, % GDP)]
Series 2: FII10@USECON
FII10@USECON [10-Year Inflation Indexed Treasury Note Yield at Constant Maturity (% p.a.)]

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