Why I'm More Positive on Global Growth

Three recent developments have reduced uncertainty.

December 2019

Nikolaj Schmidt
Chief International Economist

Three key developments over the past few weeks have improved investor confidence and should boost global growth. How much substance is behind the stories is questionable, but—as always—it is the narratives that matter. Positive stories influence sentiment more than facts, and it is sentiment that drives asset prices.

The first of these stories is about central banks and, in particular, the insistence from both the U.S. Federal Reserve and the European Central Bank (ECB) that rate hikes are a long way off. Both central banks kept their policy rates on hold this month and went out of their way to reassure the markets that they would continue doing so for the foreseeable future. They also took pains to emphasize reduced uncertainty and signs of stabilizing data, echoing recent comments from central banks in Australia, Canada, Hungary, and New Zealand.

The key point here is that central banks are slow-moving creatures and are almost certainly not going to hike in the next three months, and probably not in the next six months. However, it is worth bearing in mind that central bankers change their minds when the data change: We have not been given a guarantee, and we should be aware that central bank growth forecasts are as uncertain as those of every other forecaster. The core central banks have told us that the coast is clear (for now). But that could change.

Another important story is that the U.S. and China have agreed to "phase one" of a trade deal, including some tariff relief, increased agricultural purchases, and structural changes to intellectual property and technology issues. No actual documents will be signed until next month, and much of the detail of what has been agreed to remains unclear, but the two sides seem to at least have arrived at a truce, which is progress. Economically, it will send a signal to the world that the U.S.-China trade relationship is not completely broken—at least not yet. And while it would be a stretch to say that this will provide a major boost to confidence, less negative news is a form of positive news.

> Positive stories influence sentiment more than facts, and it is sentiment that drives asset prices.

> The key point here is that central banks are slow-moving creatures and are almost certainly not going to hike in the next three months.

Personally, I was surprised about the seriousness of the phase-one deal: The parties seem to have gone back to the agreement that collapsed in May and are now working through the document in phases. On the positive side, this is an ambitious project that reduces the likelihood of President Trump making erratic decisions to prove he is not soft on China; on the other hand, a shallow deal that would put the trade war on hold until after the 2020 U.S. presidential elections would probably have been better. For now, we will probably have a pause in the trade war news flow, at least until sometime mid-to-late February, when the phase-one deal is implemented.

Boris Johnson's victory in the UK general election—and the significantly reduced likelihood of a hard Brexit next month—is a boost for the UK and Europe. The UK is not in great shape, but it is in better shape than it was eight weeks ago, when a no-deal hard Brexit lurked around the corner. Brexit has been a drag on growth in Europe, particularly in Germany, where the composite Purchasing Managers' Index (PMI) is at 49.4,[1] signaling a contraction. Clarity on Brexit—i.e., confirmation that the UK will finally leave the EU on January 31—will provide some welcome relief, although this may only last for a while before the December 2020 deadline for the trade deal begins to loom large.

In aggregate, these developments reinforce my view that reduced uncertainty will cause growth to rebound and lead to a compression of the risk premia. I believe this will boost growth-intensive risk assets such as equities and help to keep credit spreads tight. The U.S. dollar is likely to weaken significantly, particularly against emerging market currencies. With front-end interest rates anchored by policymakers, I think we may see the yield curves of core countries steepen as the back end sells off. The steepening of the core yield curves will likely play out until central banks change their tune on rate hikes. Although emerging market rates may benefit from improving risk sentiment, I think they'll struggle to rally amid a sell-off in core yields. Consequently, I prefer higher-yielding currencies, such as the Russian ruble and the Mexican peso.

[1] As of December 15, 2019.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T.RowePrice®

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. The views contained herein are those of the authors as of December 2019 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Investors will need to consider their own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy.

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc.

ID0002876 (12/2019)
201912-1038887