T. Rowe Price®
INVEST WITH CONFIDENCE

FEARS OVER A RECESSION ARE LIKELY EXAGGERATED

APRIL 2019
Nikolaj Schmidt
Chief International Economist

SLOWING GROWTH LOOMS, FOLLOWED BY A RECOVERY

Recently there has been a lot of nervous chatter about whether the global economy is “late cycle” or not – and therefore whether a global recession is on its way. I don’t think that we’re heading into a recession, but neither do I believe – as some do – that we’re on the verge of a rebound. Instead, I think we’re facing another six months of weak growth, probably followed by a capex-fueled recovery.

Global growth has been declining for the past 12 months or so. There are three main reasons for this. First, China has been cracking down on financial leverage, hitting the country’s credit growth – and when credit growth slows in China, growth slows in the rest of the world too: according to the IMF, China accounts for around 25% of global capital formation. Second, political uncertainty has been heightened by the rise of populism and trade disputes. Companies deciding whether to spend a billion dollars on capital usually like to know what kind of environment they’re trading in and when this isn’t clear, they tend to hold back. This slows down growth.

The third factor weighing on global growth has been monetary tightening in the US. A strong dollar means that capital flows from the periphery to the core, and that is never good for global GDP.

I believe that the three causes of the slowdown are still in operation and that growth will therefore continue to slow for the next six months at least. At the same time, however, monetary and fiscal authorities are taking steps to lean into these headwinds. Overall, I don’t think we’re heading into a recession because the conditions that usually precede a recession are not in place.

Recessions are usually preceded by major macroeconomic imbalances such as consumption or investment booms that typically transmit to high current account deficits, indebtedness and, at times, rampant increases in house prices. But there have been no capex or consumption booms in the past few years that would cause a macroeconomic imbalance of the severity that would require a recessionary purge. True, US corporate debt levels are high and wage pressures are building, which poses a risk to profit margins and therefore investment. These may be at the root of the next recession, but they are not sufficient to cause one imminently, in my view.

If my no-recession-view is correct, a recovery may arrive later this year or early next year. Mostly likely, the Fed will remain on hold, but it’s possible that slowing growth may persuade it to transition to a mid-cycle easing of two-to-three cuts to aid the recovery. With a weak growth outlook, we do not see a rate increase by the ECB any time soon. In China, we expect that the authorities will continue to do whatever they have to in order to meet their growth targets. Although macro imbalances have been allowed to build in China over the past years, the authorities still have sufficient levers to support the economy as needed – in fact, the deleveraging over the past 18 months has served to increase their firepower.

FOR INVESTMENT PROFESSIONALS ONLY. NOT FOR FURTHER DISTRIBUTION.

“I believe that the three causes of the slowdown are still in operation and that growth will therefore continue to slow for the next six months at least.”

Overall, looser financial conditions and the fiscal loosening that is underway in the three major regions should be enough to support a recovery. A reduction in global uncertainty in the form of a tapering of the trade war would further help matters.

Until the recovery arrives, we expect the slowdown in growth to keep equities subdued. Rates should remain low, although opportunities may arise to invest in the bonds of countries where there is the potential for rate cuts, such as South Africa, Mexico and Russia. Brazil has the potential for considerable growth without generating inflation.

Emerging market (EM) currencies look reasonably attractive, particularly those in Latin America, which are supported by the bullish metals market. However, continued weak growth in Europe would pose a risk to EM currencies. Cheap currencies in economically-troubled countries such as Argentina and Turkey offer strong carry potential, although the spectre of inflation means that they are not without risk.

Important Information

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

© 2019 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.

201904-801806