Looking Past the US Election

The US presidential election is finally behind us, though not with the outcome most people expected. Similar to last summer's Brexit referendum in the UK, Donald Trump defied the polls, the betting markets, and most expert predictions to beat highly favored Hillary Clinton. The initial market reaction was extremely negative, but markets recovered before the day was over. Right now investors are reacting mostly to the increased uncertainty and speculation about tax cuts and looser fiscal policy. It will take some time before we know anything more concrete about the impact of a Donald Trump administration on the US economic outlook.

AUTHOR:

Markus Schomer, CFA
Managing Director,
Chief Economist
PineBridge Investments, New York

The longer-term global implications

With Trump winning the election, most market participants' base case scenarios were thrown out the window. Instead of expecting more gridlock in Washington, a political situation that had proven to be quite supportive of financial markets, we now face an environment where more serious policy changes are possible. Absent concrete policy speeches, we can only speculate. But investors seem to be positioned for greater fiscal stimulus and faster inflation. That would benefit the US, at least initially, before rising debt levels crowd out the positive growth effects. Trump's more protectionist stance on trade poses a risk to the major exporters around the word, especially in Europe and Asia.

Judging from the market reaction, investors expect Mexico will be the biggest loser of the changing global growth perspectives. Trump directed much of his criticism against the US's southern neighbor. More than two-thirds of Mexico's exports go to the US. Any policy change that affects the $500 billion-per-year trade between these countries could have negative consequences for Mexico. However, the broader outlook for emerging markets is more balanced. A more serious US fiscal stimulus should boost commodity prices. However, faster growth could also increase inflation and accelerate the pace of rate hikes in the US. In addition, rising geopolitical risk could weigh on the outlook for Europe and parts of Asia.

There just is not enough information available to rewrite our global economic forecasts. We still expect business investment around the world to start improving again as tightening labor markets increase the price of adding more workers and companies shift toward adding more capital goods as long as interest rates remains low. That shift in corporate behavior should boost global trade and manufacturing, leading to a more synchronized global expansion. I am more skeptical of a serious increase in fiscal spending. Such a policy stimulus is more likely in Japan and China. High debt levels in the US and Europe more severely restrict the scope for increased government spending. Hence, our initial reaction to the election is to leave our already fairly optimistic growth forecasts unchanged at 3.4% for next year and 3.7% for 2018.

Central bank policy eases in some emerging markets

Brazil finally cut rates after gaining enough confidence that the decline in inflation this year is sustainable. The pace of consumer price increases has slowed from a peak of 10.7% in January to 8.5% in September. The prevailing recessionary conditions and the government's reform drive should slow inflation further and open the door for substantial policy easing. India has already realized much of the easing potential. The Reserve Bank started the current easing cycle in January of last year and has cut rates six times since. Growth already averaged 7.3% in the past 2.5 years, and the latest purchasing managers' indexes show a further acceleration in both manufacturing and service sector activity.

PineBridge Investments Global Macro Forecasts

	2016	2017
Global GDP Growth	2.9%	3.4%
US	1.6%	2.5%
China	6.7%	6.4%
Eurozone	1.6%	1.6%
Japan	0.7%	1.0%
Emerging Markets	3.9%	4.4%

Source: PineBridge Investments forecasts, as of 11 November 2016.

Fiscal stimulus is working in China

China remains on track to grow 6.7% this year, which would exceed the government's target. Similar to India, China's purchasing managers' indexes indicated accelerating economic activity in October. Evidently, the government's stimulus policy is working. Credit supply and fiscal spending are still growing rapidly. And the yuan continued its step-wise depreciation, weakening another 1.5% in October alone and taking the year-to-date decline close to 4%. This should boost exports in the coming months.

The lead-up to Brexit

Solid economic performance in the UK was one of the summer surprises. After a brief slump, business sentiment rebounded sharply and the dual stimulus from a weaker pound and the precautionary Bank of England rate cut in the summer may have prevented greater damage this year. However, Brexit uncertainty remains elevated and markets are vulnerable to new information. The latest was a High Court decision to allow Parliament to vote on an EU/UK deal. Investors seem to believe that reduces the chances of a "hard" Brexit. As a result, the pound rallied almost 3% against the US dollar in recent weeks.

Ireland lags in the eurozone

Finally, the eurozone economy has maintained a steady 1.5% pace this year. That's slower than last year's 1.9% growth rate, but it was largely due to Ireland. Ireland's economy grew more than 26% in 2015 after the inclusion of companies that have moved their headquarters to the island for tax reasons. So far this year, Irish GDP growth has averaged negative 1.4%. Outside of Ireland, Germany is one of the few economies reporting stronger growth in 2016, while France, Italy, and Spain all showed a slightly slower growth trend.

So, what about that December Fed rate hike?

The immediate election aftermath seems to strengthen the case for another Fed rate hike. The market reaction to the election was quite orderly, which should ease concerns about potential financial market volatility. If the committee members really believe Trump's economic policy will be inflationary, the case for higher rates should be much easier to make. Furthermore, the economic news flow in the past few months has been supportive of another rate hike. GDP growth picked up in the third quarter, and Consumer Price Index inflation jumped from the 1% average through the first eight months to 1.5% in September. The fed funds futures market is pricing in a probability of more than 80% of another rate hike in December.

From here forward, market participants will look out for any clue of what a Trump presidency will mean for US fiscal policy. But after a few weeks where election nervousness dominated, the Fed and the economy should be back in focus as well. The third-quarter GDP reporting season has been positive so far, supporting our global growth reacceleration forecast. Inflation is already gradually rising across most economies. The Trump election victory likely just reinforces the themes that already dominated the global macroeconomic outlook.