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Global economy: In the grip of growth fears

■ The new projections of the FOMC show a downward revision to growth in 2019, a slower pace of Fed tightening and a lower cyclical peak level of the federal funds rate ■ Lower bond yields, a weaker dollar and a global decline in equity markets show that investors are in the grip of a growth scare ■ This is also echoed in a survey of US CFOs but this is at odds with the outlook for the drivers of economic growth ■ Growth worries probably reflect a focus on tail risk (rather than on the mean forecast) which may be explained by rising uncertainty

The FOMC projections are unambiguous: the 2019 growth forecast has been revised downwards (the opposite happened in the September projections), the unemployment rate in 2020-21 is expected to be higher, the pace of further tightening is projected to be slower and the cyclical peak in the fed funds rate has been trimmed as well. Foreign exchange markets have understood the message: the dollar weakened versus the euro, not because of a risk-on switch (which tends to be reflected in a stronger euro), but because of the prospect of monetary desynchronisation next year with the Fed slowing the pace of rate hikes and the ECB starting to hint at an upward move in rates.

Wall Street and equity markets globally didn't like the message: when dovish guidance causes a decline in risky assets it is clear that investors are in the grip of growth fears. In that environment, ebbing concerns about rate hikes are of no avail. Corporate executives are also increasingly concerned, witness the decline in business sentiment and export expectations in Germany this week (IFO data). More tellingly, Duke University's Fuqua School of Business quarterly survey of US CFOs shows that close to 50% expect a recession by the end of next year and 82% think that a recession will have begun before the end of 2020. This is in sharp contrast with current quarter estimates for growth: the Atlanta Fed nowcast stands at 2.9% and the New York Fed expects 2.4%.

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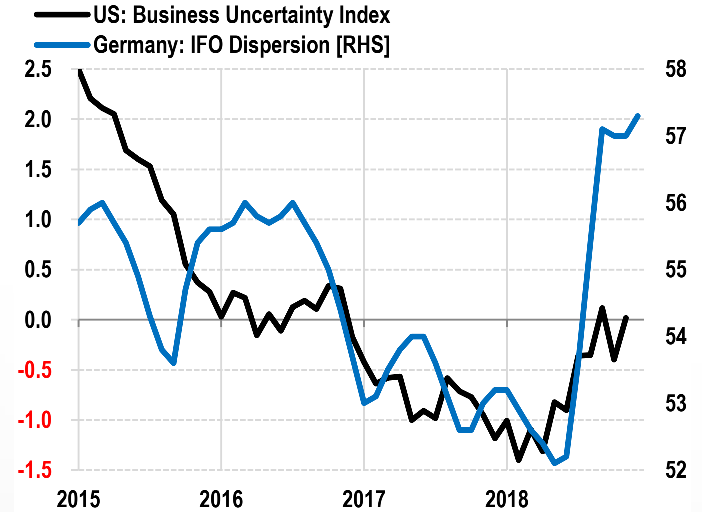
UNCERTAINTY INDICATORS FOR THE US AND GERMANY *



Source: IFO, Federal Reserve bank of Atlanta, BNP Paribas

*The IFO index shows to which extent the expectations of individual companies regarding the six-month business outlook differ. This dispersion is considered as a measure of uncertainty. The Atlanta Fed Survey of Business Uncertainty indicator is based on the probability distribution over 12-month-ahead sales, employment, unit costs, and capital expenditures for each firm which participates in the survey.

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Judging by the very low level of unemployment, the pick-up in wage growth, the expansion of real disposable income, the expected growth of company earnings, one struggles to see what would cause such an abrupt stop in this cycle, unless confidence would drop significantly. This doesn't happen without a reason of course. An obvious candidate would be a sharp decline of Wall Street with investors becoming significantly more risk averse. This is a drop of confidence with another name, so the reasoning is circular. However it could also reflect that the market focuses more on the decline of economic growth than on the forecasted level which should remain more than satisfactory (the FOMC projects 2.3% next year).

Another reason is what Mario Draghi last week called 'general uncertainty': the underlying cause may evolve but uncertainty remains at a high level, or, as shown by company surveys, is even on the rise (see chart). This could imply that markets and companies focus on tail risk, rather than on the mean growth forecast. In this regard, positive news on the US-Chinese trade dispute or on the Brexit issue, would be most welcome. Let's make this our New Year's wish.

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