Weekly Perspectives

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A Weekly View of Global Economies

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North America
Second-half GDP growth in the US will depend largely on business capital spending and household consumption expenditures. As far as the corporate spenders are concerned, it looks like they are demonstrating a greater degree of reticence in actually using all the funds that they had earlier allocated to capex. It's a cautious wait-and-see attitude. The warning signs first appeared in the software firms' earnings reports and guidance, and lately, also, in the hardware sector.

Looking at the prospects for household spending, we need only reiterate the challenges they are facing. The helping hand of expansionary fiscal and monetary policies is no longer operative. At the same time, job growth is weaker than expected, wage gains are marginal and oil prices are taking a bite out of disposable income. It is becoming more difficult for consumers to keep up with optimistic expectations of robust spending growth.

The rosy Fed outlook for the economy is premised on stronger employment growth and a rapid decline in oil prices. Essentially, they expect the US economy to repeat the experience of the 1990's - - namely, a high average level of non-volatile growth. They overlook significant imbalances overhanging the economy, in the form of the large fiscal and current account deficits, and ignore a more problematic international environment than held sway in the nineties.

The outlook for the global economy is one of ongoing slowdown, but nothing more ominous than that. In other words, we are not expecting a slide into a recessionary phase in major regions. Tightening of fiscal policy is unlikely to be effected in much of Europe, North America and Japan, even though most of them need to have their deficits trimmed. It also appears that central banks will be very careful about further interest rate increases. Meanwhile, oil prices are a bit worrying but, barring major supply problems, they should start to moderate.

The stock market has had a rough time over the past month and a half, but things aren't so dire that risk appetite has been squelched. Going forward, some investors and traders may decide that the indicators they follow are emitting signals of oversold conditions, and this could be the genesis of a technical rally. It could also be the start of more volatility, a state of affairs dear to the heart of many hedge fund managers and, more particularly, their bank accounts.

What is remarkable in the past few years is the willingness on the part of US investors, both institutional and retail, to take on more risk as conditions improved. Risk aversion did not become a deep-seated condition, as a result of the experience of the previous bear market. Part of the reason is that, in the correction of 2000-2002, the stock market gave back only part of the increases it registered in the nineties. Consequently, long-term investors were still sitting on decent gains, even after taking some hard knocks.

Looking at retail investors, a more substantial reason for the ease with which risk appetite can be fired up is the US households' need for substantial retirement funds. Americans want to maintain high consumption levels during their working lives and be able to finance a very comfortable retirement, too. So they need to combine a low savings rate with a high return on investments. The exceptional equity returns of the 1990's suited them just fine.

However, the lower-return environment of the current decade constitutes a challenge, in terms of meeting their objectives. This may drive them to take on more risk, in the hope of getting higher returns. Otherwise, they will have to deal squarely with the trade-off between current consumption and future consumption. Not more of both, but more of one and less of the other - - possibly forcing them to increase their savings rate.

Europe
With global growth projected to advance at a more relaxed pace for the balance of this year, Europe shouldn't be looking for help from exports, in order to boost activity. This means that there will be more reliance on domestic demand, rather than the external sector, and we'll have to monitor the former for signs of a pickup. The outlook for business investment is a little brighter now, but there are still worries about the vigour of consumer spending.

Asia/Pacific
Asian stock markets have been hurting, on account of worries about technology spending in the Unites States, as well as rising oil costs. In Japan, second-quarter GDP growth was much lower than consensus forecasts and this has triggered successive rounds of equity selling. The nasty surprise came right after the release of an upbeat report on the Japanese economy by the IMF. Worries about the strength of domestic demand and overdependence on exports have come to the fore again.

Bonds
Upbeat talk from the Fed has failed to fire up enthusiasm among investors that higher growth is around the corner. Accordingly, the yield on the ten-year Treasury note has edged lower. The chirpy chatter from policymakers has led the markets to factor in at least one more 25 bps rate hike this year. So credibility may require the Fed to deliver that much, as a minimum, to satisfy expectations.

Currencies
Bearish sentiment has continued to weigh on the dollar and, thus far, it has been unable to regain much of the ground that it lost against the euro, this month. A relatively positive data report, released by the US Treasury, showed that new portfolio inflows into the United States, in June, were able to cover the wide trade deficit by a decent margin. But the good news wasn't enough to lead to a substantial dollar rally.

Foreign investors increased their purchases of US stocks marginally, but it wasn't sufficient to counteract the outflow caused by Americans buying international stocks - - leading to net equity portfolio outflows. On the fixed-income side, there was still good appetite for Treasuries from the Bank of Japan.

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