AQUILA FLASH

Aquila & Co. AG | 10 July 2017

Broad-based and synchronized acceleration in global growth

The business environment for markets remains good. A broad-based and synchronized acceleration in global growth has taken hold. Political risk in the Euroland has significantly reduced. Indeed, it may well be that political risk is now higher in the US than in Europe. Global geopolitical risks are, however, high. Declines in bond yields and inflation rates are in our opinion only temporary and mainly a function of the renewed decline in the oil price. We think that inflation rates and interest rates will rise again in the second half of the year.

The world economy is growing strongly

We expect an acceleration in world economic growth to between 3% and 3.5% this year. The recent decline in oil prices has caused a slight reversal in the broader trend towards reflation. But geopolitical risks are well above average (North Korea, Qatar, Syria, Iran etc). In France, President Macron has a good chance of implementing parts of his reform program but we don't expect massive change. France's 35 hour work week and its very low retirement age of 62 look unlikely to be challenged. On the other hand, the hitherto moribund German-French axis could get a new burst of life.

The US is moving towards a normalization of monetary policy and becoming a net oil exporter.

The US unemployment rate has now fallen to 4.3%. Meanwhile, the Purchasing Managers' index for manufacturing has risen from 54.9 to 57.8 (versus an expected 55.3). The new orders component reported a very high figure at 63.5. The index for purchasing prices fell from 60.5 to 55 (against an expected 58.5). In the manufacturing sector inflationary pressures remain very low. The index of consumer confidence rose strongly once more from 117.9 to 118.9 (versus an expected 116). President Trump wants America to return to being a net oil exporter. We expect the Fed to announce one further rate rise in 2017 and to begin shrinking its balance sheet towards the end of the year. But further strong gains in the US stock and property markets would likely trigger countering measures on the part of the Fed. For 2017, we believe a growth forecast of 2.5% to 3% is realistic. But, longer term, the Trump administration must show that it can implement at least parts of its reform agenda.

Eurozone: Reforms in France

Investor confidence in the upswing is growing. The Purchasing Managers' index for manufacturing rose again to 57.4, a high reading. Even in Italy consumer confidence managed to rise from 105.4 to 106.4 (versus an expected 105.8). Unfortunately, unemployment remains unacceptably high at 9.3%. More important than these current data points would be at least the partial implementation of President Macron's planned labor market reforms in France. We are optimistic that partial implementation can be achieved despite the strength of the forces of resistance. A strong signal could be a reduction in the corporate tax rate from 33.5% to 25%. But the very high public sector share of the French economy – at least relative to other EU states – is likely to continue.

Parliamentary elections in Italy are not scheduled until 2018 and are therefore unlikely to hit the headlines until the end of this year. We expect the Eurozone to grow 1.9% in 2017. The British Purchasing Managers' index for manufacturing fell from 56.7 to 54.3 (versus an expected 56.3). The pound is substantially undervalued. A recession in the UK seems unlikely to us.

Japan: high geopolitical risk

The Japanese Purchasing Managers' index for manufacturing has reached a level of 52.4. We are sticking with our forecast of 1.2% growth for Japan this year. Given China's ongoing rearmament drive and the unresolved situation in North Korea, regional geopolitical risk is high. Japan will have to continue to increase its spending on defense.

China: surprisingly strong business cycle indicators

In China the Caixin Purchasing Managers' index has "surprised" positively, rising from 49.6 to 50.4 (versus an expected 49.8).

Switzerland: picking up steam

The KOF business cycle indicator rose 3.5 in June 2017 relative to a revised 102 reading for May. This indicator now stands at 105.5. Overall, the economic picture has continued to improve and an above average growth outturn for Switzerland now looks very likely. For 2017 we think a growth rate in the range of 1.4% to 1.9% is realistic.

Lower oil prices are boosting the world economy

Strikingly weak oil prices and the oil boom in the US have temporarily led to a falling off in interest rates and inflation pressures. Overall, an exogenous fall in oil prices – in other words a price decline that reflects new oil finds or new production methods – is a positive factor for the world economy.

Some stabilization of the oil price, and an upward drift in interest rates and inflation rates, are likely

We expect a stabilization in the oil price and as a result should ease further deflationary pressures. With unemployment at 4.3% in the US and only 5.5% in Germany, higher wage inflation may well become a more important issue. On this basis, our forecast is for gently rising interest and inflation rates.

Contact: Thomas Härter, Investment Office
Tel.: +41 58 680 60 44