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Chief Economist Newsletter

Despite risks, stability is returning to global economic growth

At the end of last year, cracks in global economic growth began to emerge. In response, central banks and governments around the world took a more cautious stance and in some cases have turned to providing additional stimulus measures. For example, the U.S. Federal Reserve suggested that in the current economic environment, no further interest rate hikes would be needed this year and the European Central Bank indicated that it will likely keep interest rates low for a while longer.

There are some signs that the change in tone of global policymakers has helped to stabilize global growth, albeit at a more modest pace. That said, risks to the global outlook remain, with three issues in particular that could potentially slow global growth further: Brexit, declining global home prices and trade tensions—the latest U.S.-China showdown is only intensifying the situation. U.S. economic data will likely begin to turn a bit more positive in the second quarter. Outside the U.S., the global economy is slowing, but still growing, with plenty of pockets of risk. Even with such ever present risks, the stability in global economic data in recent weeks has helped to sustain confidence in the view that global economic activity should muddle along for now.

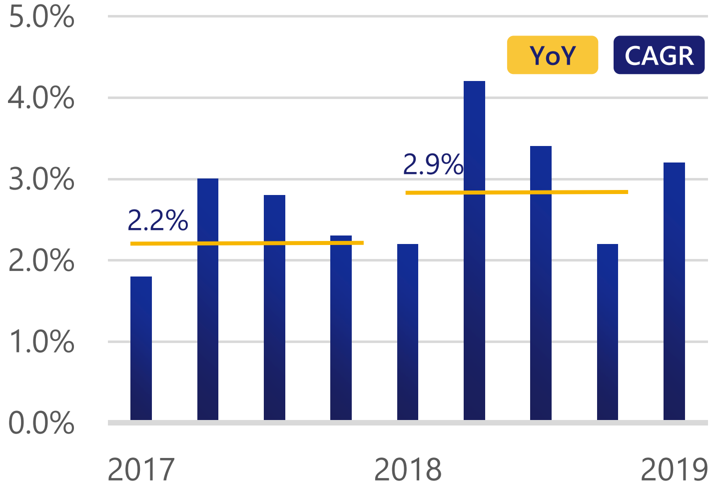
Early 2019 U.S. growth higher than expected, but outlook remains cautiously optimistic

Politics is the one word that summarizes the most acute risks to global growth this year

The global economic landscape, with updates on Europe and China

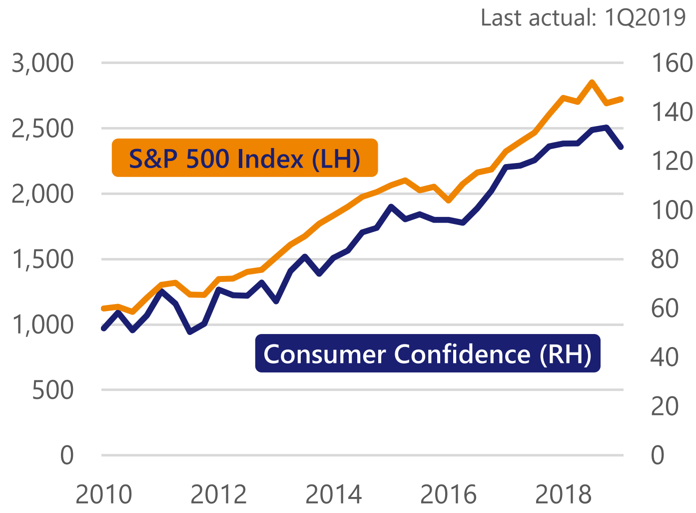
Implications for U.S. consumer spending

Real GDP (Year-over-year percent change, compound annualized growth rate)



Source: Visa Business and Economic Insights and U.S. Department of Commerce

Consumer Confidence Index and the S&P 500 Index



Source: Visa Business and Economic Insights, Standard and Poor's and Conference Board

U.S. Economy: Temporary bump or start of a recession?

Worries about a U.S. recession began in earnest following a string of disappointing economic data for the month of December, including a 1.6 percent (month-over-month) decline in retail sales, the largest drop since September of 2009. The Fed's current caution combined with the disappointing global economic data briefly sent short-term interest rates higher than long-term interest rates (a yield curve inversion). Yield curve inversions have historically been seen as a potential recession indicator. A higher-than expected GDP reading in 1Q2019 likely makes these worries unfounded, for now.

On the consumer front, real wage growth continues to accelerate as the tight labor market has begun to flow through to income growth, and job gains remain stronger than expected. The recent string of equity market gains has also helped to lift consumer and business confidence. The after effects of the government shutdown should lift government spending over the next two quarters. Housing market data has also begun to show signs of improvement now that interest rates have begun to stabilize. The U.S. economic outlook remains cautiously optimistic.

A spring thaw for Europe

European economies have begun to offer some encouraging signs of a spring thaw. After the perilous drop in consumer confidence at the end of 2018, consumer sentiment seems to have stabilized in the Eurozone, particularly in France and Ireland. Household spending is still guarded in Germany, but it is accelerating in France. Eurozone retail sales data paint an improving picture of the domestic economy in the first quarter of 2019. In general, macroeconomic conditions remain favorable for the consumer, with the unemployment rate continuing to decline in most countries–Italy being the notable exception.

Wage gains are picking up, and with inflation hovering around 1.5-2 percent, real disposable income is improving at a healthy 2-2.5 percent rate. Although the Eurozone's manufacturing sector continues to suffer in the face of external headwinds, domestic investment appears to show signs of resilience. Similar to the U.S., concerns about a downturn in Europe are waning. While a spectacular recovery in growth is unlikely, a moderate pace of growth in consumer spending is anticipated.

Kicking the Brexit can down the road

Brexit remains the wild card for the United Kingdom. The deadline extension to October 31 should be a positive for tourism in the critical summer months: open borders and fairly stable exchange rates should encourage outbound British vacationers heading to Mediterranean beaches, as well as inbound European visitors to London/Scotland. For the business sector, the delay is less favorable—too long to feed confidence that uncertainty will quickly dissolve, yet too short to warrant a resumption of business-as-usual investments. Nonetheless, the U.K. shows some of the same positive fundamentals as those noted for the Eurozone: low unemployment, rising wages and salaries, low inflation, and stabilizing confidence—a positive mix to create momentum over the summer.

Elsewhere in Europe, risks linger in Italy, where a recession took hold in the 2Q2018, and signs of a turnaround are hard to find. The unemployment rate rose back to 10.7 percent, consumer confidence is steadily slipping, and retail sales are stagnant. Thus, the country will likely miss the fiscal targets set by the European Union. In the fall, the Italian government will be called upon to make a tough decision between sizeable budget cuts or tax increases, or risk further political frictions with the European authorities. The likely budget tension may result in Italian government bond yields edging higher once again.

China's policy measures leave stabilization in sight

China's economy continues to slow. De-risking and deleveraging in the shadow banking sector are now well advanced with no signs of systemic instability. The reversal of front-loaded orders associated with tariffs is weighing on the trade data and there are signs that this weakness is spreading in Asia. Evidence of manufacturing weakness also exists, but recent value-added tax cuts should not only alleviate margin pressure but also eventually lead to greater investment and employment. China responded to the economic downshift with stimulated growth, adopting a more measured approach to easing likely to be less stimulatory short term but more sustainable long term. As a result, consumer spending has stopped decelerating and discretionary spending is improving.

Personal income tax cuts implemented at the end of 2018 could support household spending if unemployment stabilizes rather than increases, like it did recently. The property sector accounts for a large share of investment and the cycle is typically managed quantitatively through lending quotas and other restrictions. Property easing measures are unlikely to be as pronounced as in previous cycles to avoid unwanted speculation in the housing market. Overall, the pace of moderation in the Chinese economy appears to be slowing. Barring any unexpected shocks, it should stabilize in 2H2019.

Risks to global growth: Politics is the biggest one

The latest U.S. tariffs on Chinese goods have raised trade tensions further and will continue to keep Asia's growth prospects uncertain. The new NAFTA agreement between the U.S., Mexico and Canada (USMCA) has been back-burnered by the U.S. Congress, leaving another cloud over North American trade. In addition, Brexit remains a significant source of uncertainty for the U.K. economy. This could create a financial market sell-off and ding confidence around the world. A more tangible risk facing global consumers is falling home prices, which fell 1.6 percent in 3Q2018 compared to the preceding quarter, according to the IMF.[1] This was the largest quarterly drop in the index since 2008. Much of this weakness has been concentrated in previously high-flying metro areas such as Dubai, London, Vancouver, Sydney, Beijing, Singapore and Hong Kong. The latest statistics indicate the trends from late last year will extend into 2019. The forces cooling these markets from slowing global growth, higher interest rates and local regulatory changes are also leading to slower price gains in other top cities, including most of the major U.S. metro areas. Should this trend continue, the negative wealth effects from these falling prices could cool spending to a greater degree than currently expected.

Implications for U.S. consumer spending?

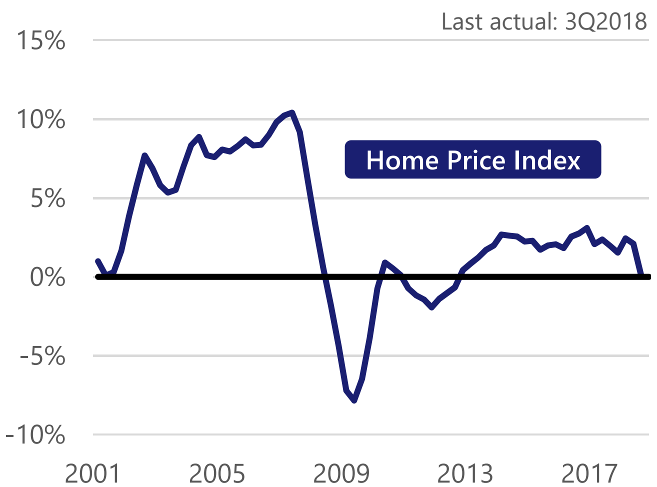
What impact does this global landscape have on U.S. consumers? For starters, Brexit uncertainty and trade tensions could result in global stock market volatility. This could erode U.S. consumer confidence and, in turn, spending, just as it did last December. Conversely, home price declines globally could send more capital into the U.S., which would have effects on everything from reducing U.S. long-term interest rates to strengthening the U.S. dollar, making imported goods less expensive for U.S. consumers.

It is important to put these global risks in a broader context. Historically, economic downturns abroad rarely result in a downturn in the U.S. Rather, it is usually the U.S. economy that tips the global economy into recession, as shown in the graph below. For now at least, the global about face to stimulate growth around the world appears to be helping most economies.

[1] International Monetary Fund. (Jan. 31, 2019). Global House Price Index. https://www.imf.org/external/research/housing/

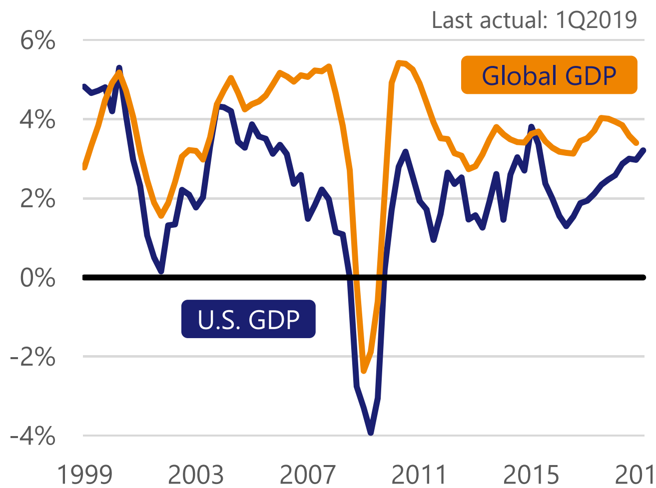
[2] OECD, global GDP, 4Q2018, Quarterly National Accounts, https://stats.oecd.org/OECDStat_Metadata/ShowMetadata.ashx?Dataset=QNA&ShowOnWeb=true&Lang=en

Global Real House Price Index (YoY percent change)



Source: Visa Business and Economic Insights and International Monetary Fund

U.S. GDP vs. global GDP (YoY percent change)



Source: Visa Business and Economic Insights, U.S. Department of Commerce and the Organization for Economic Co-Operation and Development (OECD), GDP, 4Q2018, Quarterly National Accounts[2]

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