

Global Macro Strategy Forum

The world in pictures

Economics

Global

Recent jitters notwithstanding, the world looks ok

In this issue of the Global Macro Strategy Forum we present with annotated charts a snapshot of how growth, monetary, and financial conditions are evolving in the world economy. Overall, the picture is promising, even if some areas of concern are discernable, above all in selected emerging economies. Traditional leading indicators and our surprise indices point to building momentum in the world economy. Jitters about global growth or about the recoveries in the US and Europe have little basis in the broader dataflow.

Global growth underpinnings

Recoveries in the US and Europe are underpinned by favourable financial and monetary conditions, rising global production, as well as receding balance sheet and fiscal headwinds. In China, real income gains are lifting household consumption. The recoveries of global production and world trade are also positives. China's credit growth is moderating, but is unlikely to choke off economic activity abruptly in areas such as property or infrastructure investment.

The emerging dimension

Globally, manufacturing output is picking up, underpinned by rising orders relative to inventories. That's welcome for emerging economies that have otherwise reached the end of domestic demand (and credit-supported) expansion phases. But it is more favourable to manufacturing than to commodity extraction sectors and countries. Lastly, emerging financial stresses are significant, not because of the size of the economies at risk, but rather because any dislocations that raise risk premiums and the cost of capital could quickly erode the world economy's scarcest resource—confidence.

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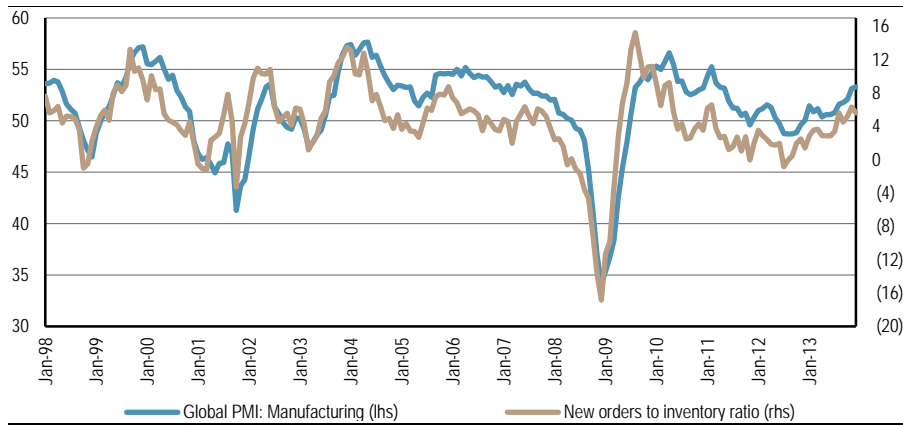
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Cyclical indicators

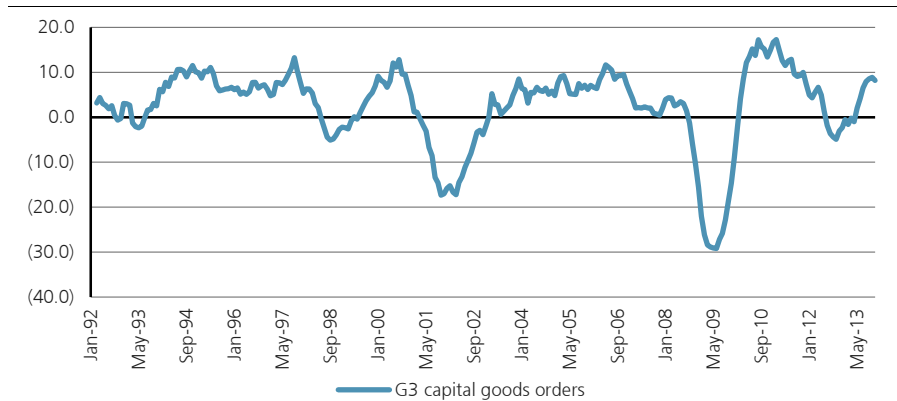
Figure 1: Global PMIs and the ratio of orders to inventories



Source: Haver, UBS estimates

Global manufacturing output is increasing as new orders rise relative to inventories. In the advanced economies a drawdown of inventories since 2013 is underpinning a rise in global goods production, a chief reason why manufacturing PMI's are stronger than services PMI's.

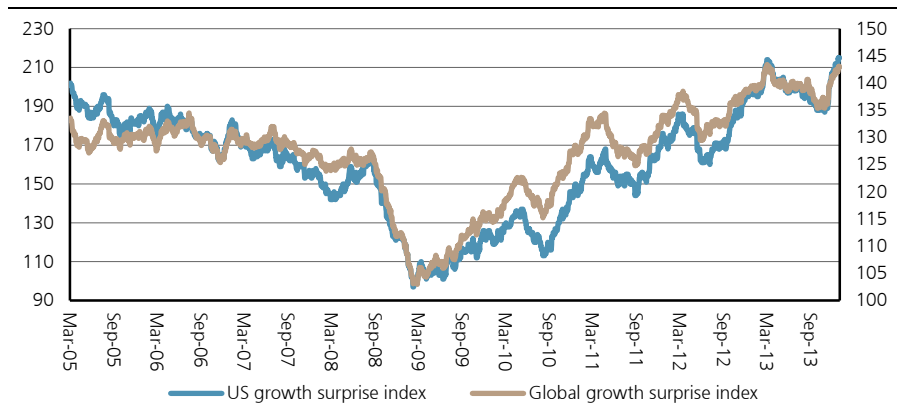
Figure 2: G3 capital goods orders, % y/y three-month moving average



Source: Haver, UBS estimates

Despite a disappointing US durable goods orders report this week, overall capex spending intentions continue to improve in the advanced economies, as evidenced by rising orders for capital goods.

Figure 3: US and global growth surprise indices

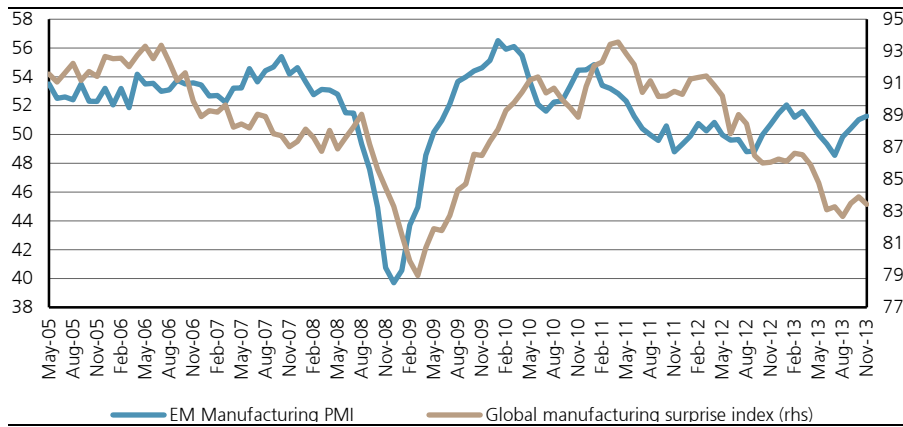


Source: Bloomberg, UBS estimates

Global growth surprises surged in the final months of 2013, underpinned by broad-based outperformance in the US. That outcome bodes well as a jumping off point for global growth in 2014.

Emerging economy indicators

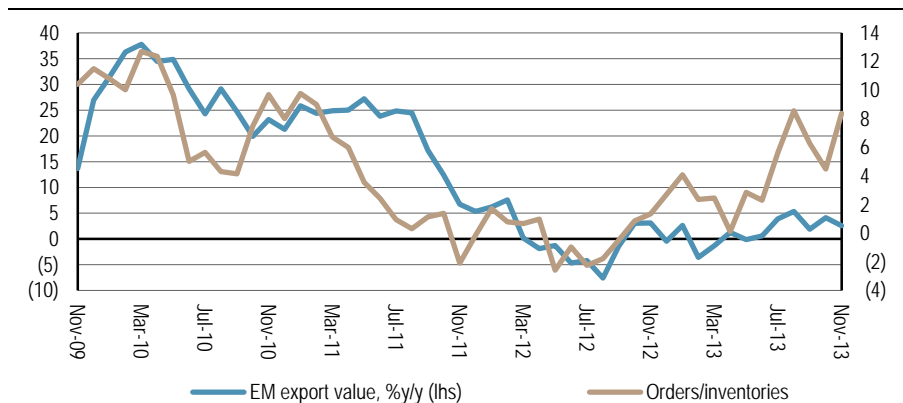
Figure 4: Emerging PMI's and global manufacturing surprises



Source: OEF, Bloomberg, National sources, UBS estimates

Emerging economies, which have lost credit-led domestic demand momentum, are likely to benefit from an ongoing upturn in global manufacturing and trade.

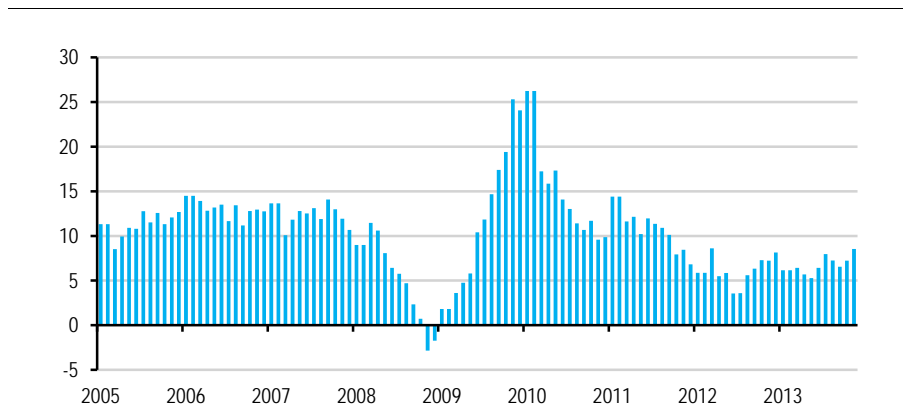
Figure 5: Emerging economy exports versus the orders/inventory ratio



Source: Haver, National sources, Bloomberg, UBS estimates

Thus far, however, the recovery of emerging economy exports has been subdued. Export values have lagged the improvement in global orders to inventories. Soft commodity export conditions are partly responsible.

Figure 6: China physical activity index, % change y/y

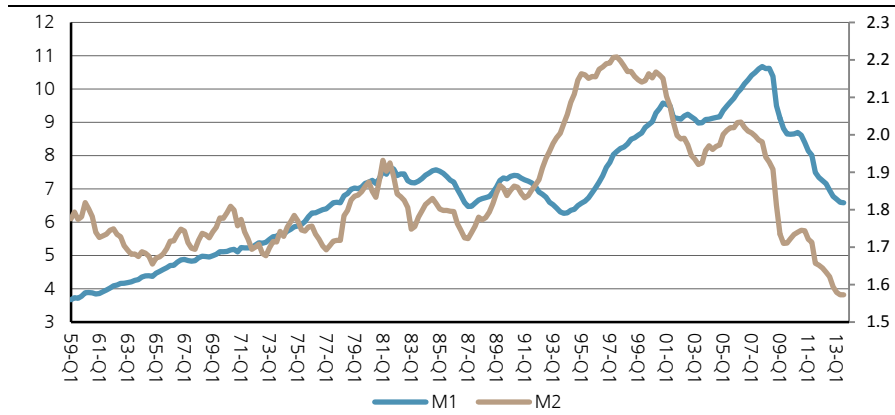


Source: CEIC, UBS estimates

Monthly economic activity in China—as captured in our composite physical activity index—gained momentum in the final months of 2013, lifted by rising production, exports and consumer spending

Financial conditions

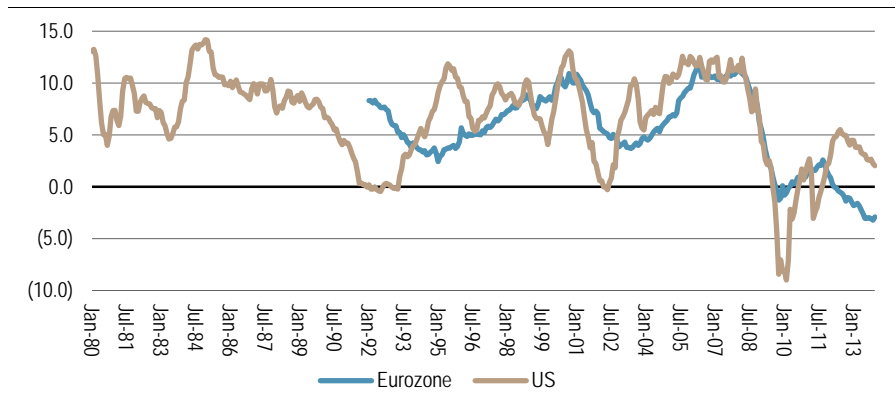
Figure 7: Velocity of money in the US



Source: Haver, Federal Reserve Bank of St Louis, UBS estimates. Money velocity equal to nominal GDP divided by the relevant monetary aggregate.

The velocity of money in the US continues to decline suggesting little risk of rising inflation. Accordingly, the Federal Reserve can continue to withdraw policy accommodation at a measured pace, maintaining supportive financial conditions.

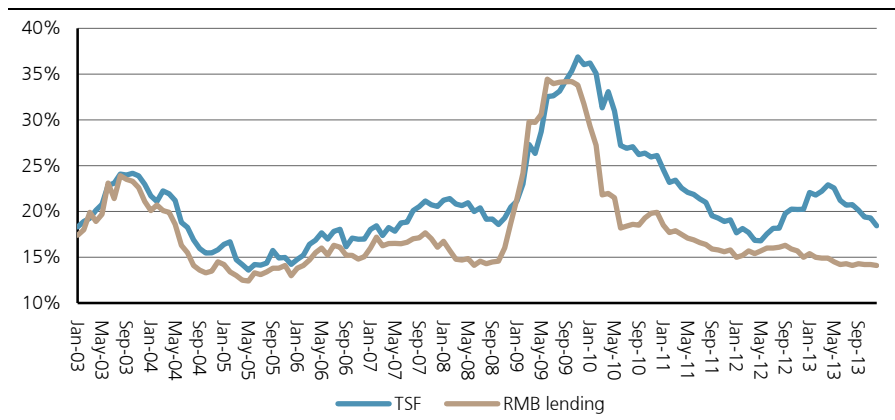
Figure 8: Bank lending to the private sector, % change y/y



Source: Haver, ECB, Federal Reserve, UBS estimates

Bank lending to the private sector (households and firms) is positive, but tepid, in the US. In Europe, private sector de-leveraging continues, though the pace may be finally slowing.

Figure 9: Total social financing and bank lending in China, % change y/y

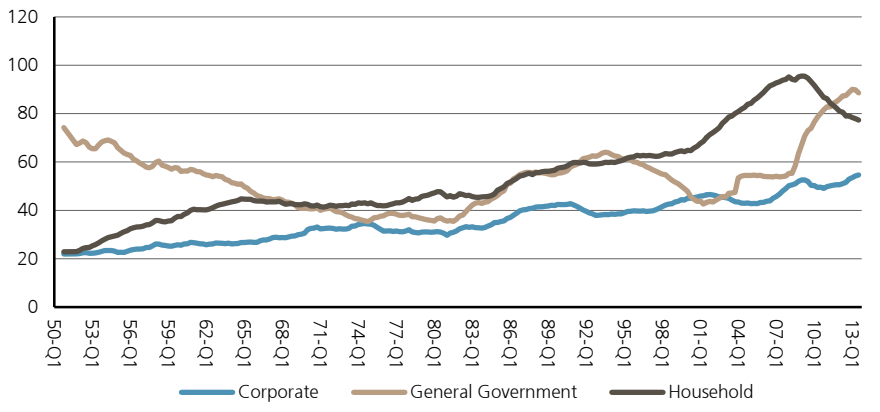


Source: CEIC and UBS estimates

While slowing, both total social financing (off balance sheet) and bank lending (RMB loans) remain supportive for growth in China. The aim of policy is to slow credit growth, particularly TSF, in a gradual and measured fashion.

Balance sheet indicators

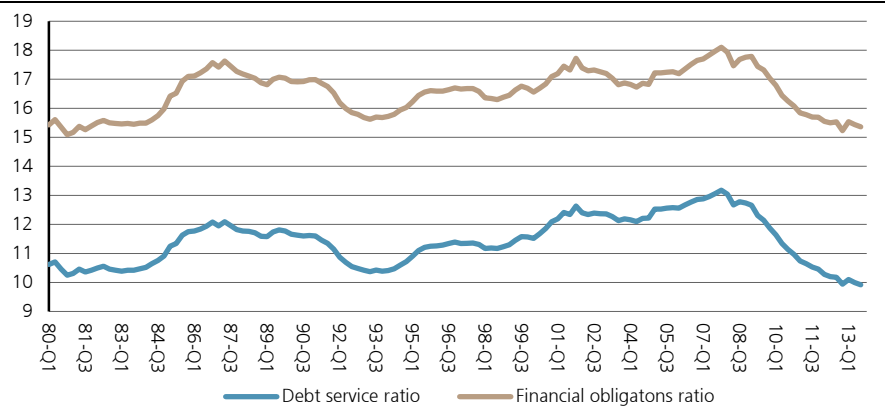
Figure 10: Total debt as share of US GDP, in percent



Source: Haver, Federal Reserve, UBS estimates

Household indebtedness as a share of US GDP has fallen by about a fifth since the financial crisis, offset by some increase in corporate indebtedness and a large jump in government indebtedness

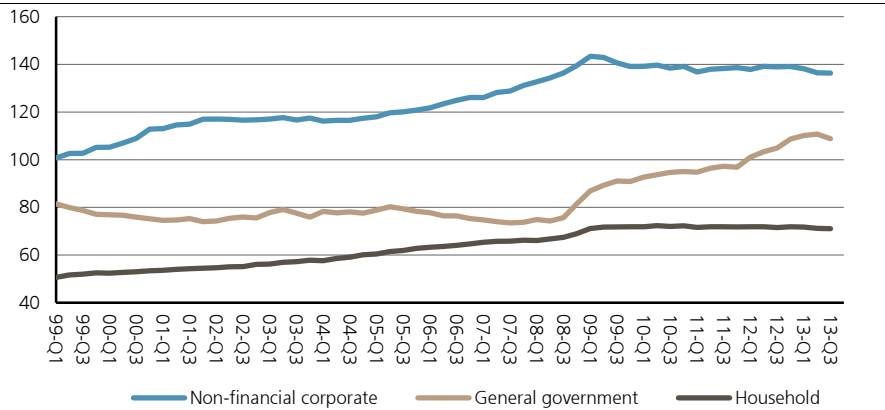
Figure 11: US household debt service and financial obligations ratios



Source: Haver, Federal Reserve, UBS estimates. Note: As a percentage of disposable income

As a result of smaller debt burdens and lower interest rates US households devote a smaller fraction of income to debt servicing (or to meet broader financial obligations such as rent or insurance payments) today than at any time since the early 1980s, leaving them with greater discretionary purchasing power.

Figure 12: Eurozone sector indebtedness, as a percentage of GDP

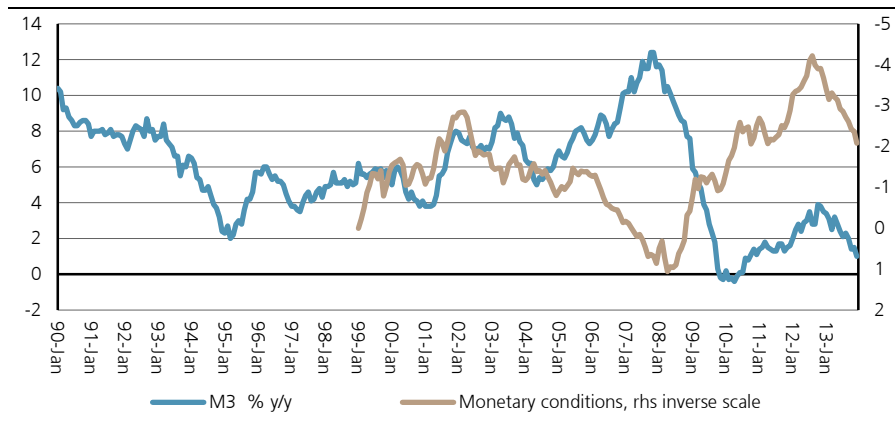


Source: Haver, EU, UBS estimates

Eurozone corporates have been gradually de-leveraging since 2008. Meanwhile, general government indebtedness has climbed sharply. Unlike their Anglo-Saxon peers, Eurozone households are relatively un-levered.

Policy indicators

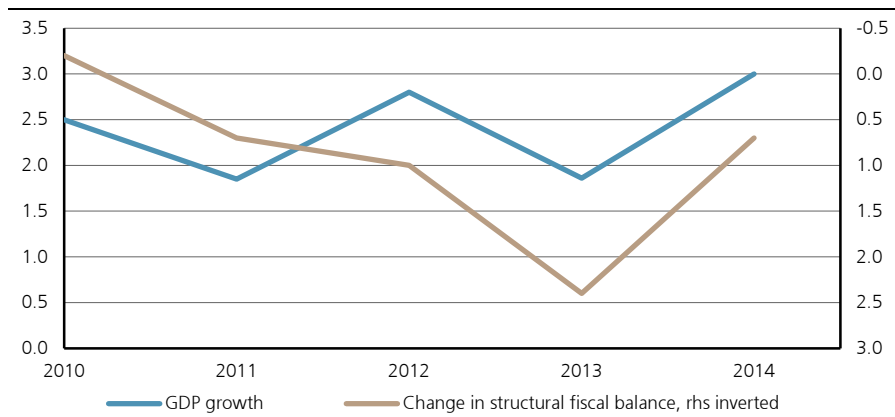
Figure 13: Eurozone money growth and monetary conditions



Source: Haver, ECB, UBS estimates Note: An increase in monetary conditions represents a 'tightening'

Eurozone M3 money growth remains tepid. Monetary conditions have actually tightened somewhat, courtesy of a stronger euro in global foreign exchange markets and falling inflation (which has made real short-term interest rates less negative).

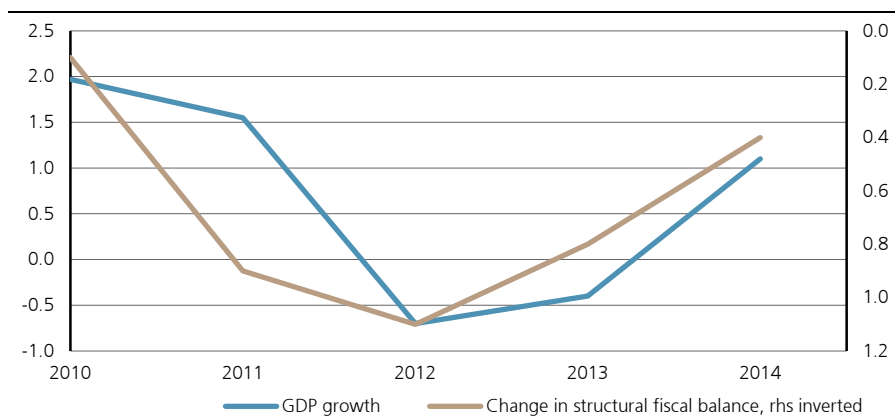
Figure 14: Change in structural fiscal balance and real GDP growth (US)



Source: Haver, IMF World Economic Outlook, UBS estimates Note: An increase in the structural fiscal balance represents a 'tightening' (i.e., decline in the structural deficit)

Fiscal drag in 2013, resulting from tax increases and the 'sequester', restrained US real GDP growth. Given less fiscal tightening in 2014, growth ought to accelerate.

Figure 15: Change in structural fiscal balance and real GDP growth (Eurozone)

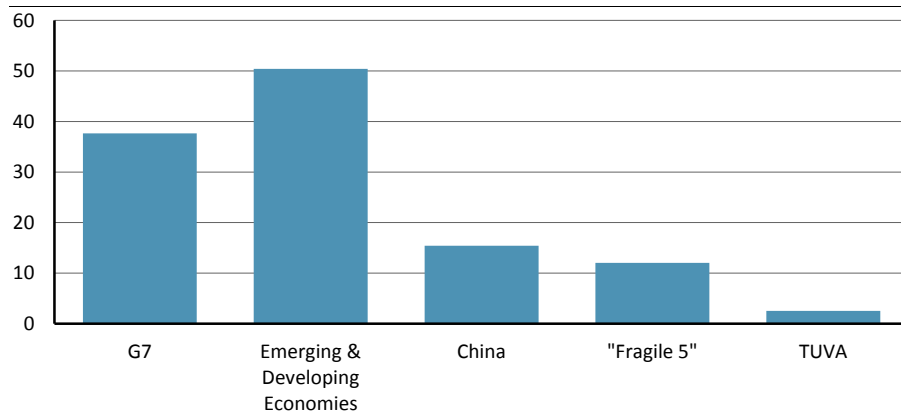


Source: Haver, IMF World Economic Outlook, UBS estimates Note: An increase in the structural fiscal balance represents a 'tightening' (i.e., decline in the structural deficit)

Fiscal drag in the Eurozone was particularly pronounced in 2012-2013, but will recede considerably in 2014, allowing Euro-area GDP growth to reach 1.1% this year.

Global risk factors

Figure 16: Shares in world output (as a percentage of global GDP)



Source: IMF, UBS estimates Note: 'Fragile 5' refers to Brazil, India, Indonesia, South Africa and Turkey. 'TUVAs' refers to Thailand, The Ukraine, Venezuela and Argentina

Emerging economy risk is on the rise. But while emerging and developing economies account for half of world output, those countries deemed at greatest financial risk account for less than 15% of world output (at PPP exchange rates). The risk, however, is that severe financial dislocations in any one could damage global confidence via a rise in the cost of capital.

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