

Economic Risks

- The global outlook remaining uninspiring
- Brexit triggering a return to recession for the UK
- Monetary unorthodoxy giving way to fiscal activism
- Febrile politics becoming a fact of life
- Populism breeding protectionism and bilateralism

OECD: A lacklustre and uncertain outlook

- The performance of the advanced economies remains generally mixed and uninspiring, the outlook uncertain.
- Brexit looks likely to impact the pace of real activity adversely, although the effects will differ greatly by region.
- The UK is most at risk in terms of both demand and supply, followed by Europe. The US and Asia are less exposed.
- Reduced term premia and expectations of monetary policy normalisation have pushed bond yields down to new lows.
- Business investment remains the weakest element of final demand, and is most at risk from the latest uncertainties.
- Productivity growth in most OECD economies is sluggish, and with ageing populations is depressing growth potential.
- Headline CPI inflation has begun to move back towards targets but the process is likely to be gradual.
- Monetary policy stands to remain extremely unorthodox, although the balance of costs and benefits is deteriorating.
- Political uncertainties and populism look set to remain an enduring potential destabilising factor far beyond the UK.
- Fiscal activism, and in particular increased infrastructure spending, is returning to the policy agenda.

US: Still struggling to match expectations

- At 1.2% saar, real GDP growth disappointed in Q2, although real final sales continued to expand around a 2% rate.
- Private consumption growth is robust, but business investment remains extremely sluggish.
- The unemployment rate seems to have stabilised just below 5%, although evidence of underemployment remains.
- Wage growth has belatedly begun to accelerate but, with price expectations quiescent, is unlikely to become an issue.
- Consumer price inflation seems headed back towards the Fed's 2% target, but is unlikely significantly to overshoot.
- Presidential candidates have expressed major misgivings about the global trading system as currently configured.
- Political uncertainty threatens to restrain growth in the second half and keep the Fed in a cautious frame of mind.

Bottom line: Modest growth by historical standards and risks ahead, but the US economy remains in better shape than most.

Watch for: divisions on the FOMC; choleric election politics increasingly impacting markets; and the rise of protectionism.

Euro area: Still beset by fault-lines and political disquiet

- Eurozone GDP growth cooled in Q2, but has moved within a 1½-1¾% annual rate range over the past year or so.
- Aggressive QE, cheaper oil, and less fiscal austerity have sustained output: sluggish world trade has held it back.
- The vulnerability of a still-weak EU financial sector to Brexit and falling asset prices is a significant threat.

- Headline CPI inflation remains close to zero, while core inflation is also below 1% and has been sub-2% since 2002.
- Low inflation expectations and soft wage growth suggest that the low-inflation environment is likely to persist.
- Brexit threatens to deepen divisions in the EU, while Greece's economic and political situation remains fraught.
- The ECB if anything retains an easier bias and is likely to ease again should Brexit-related risks crystallise.
- Migration and terrorism have already led to the easing of fiscal policy, and this seems likely to continue.

Bottom line: an anxious and politically dyspeptic region, replete with numerous fault-lines, and vulnerable to shocks.

Watch for: more political turmoil and unorthodox ECB easing.

UK: Brexit begins to bite

- The available post-Brexit survey evidence points to a major slowdown for an already unbalanced economy.
- GDP growth is set to drop sharply; a severe investment 'stop' threatens a rapid slide into recession.
- The challenging economic environment has already encouraged the government to 'reset' its fiscal policy plans.
- There is a clear case for policy stimulus. The immediate responsibility will fall to the Bank of England's MPC.
- The degree to which fiscal policy is employed to support output will become clearer in November.
- A record external deficit threatens exaggerated sterling weakness that could greatly complicate the policy response.
- CPI inflation remains just above zero, but the fall in the pound means it is set to rise some way above target in 2017.
- Trade and other Brexit negotiations stand to be extended and much harder than is generally perceived.

Bottom line: slower growth and growth potential, higher inflation, difficult policy choices.

Watch for: a zero Bank Rate; a sterling crisis; turbulent politics.

Asia and the BRICS: The BOJ approaches the end of the road

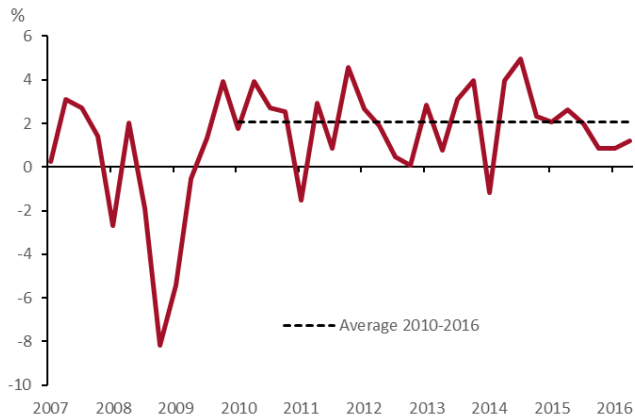
- Another round of hefty policy stimulus has sustained Chinese output, but potential growth continues to weaken.
- High debt burdens are reducing policy traction and threaten balance sheet adjustment across much of Asia.
- Yen strength has left inflation far adrift from target. The government has announced a 26th round of fiscal stimulus.
- The BOJ is conducting a thorough reassessment of monetary policy. Helicopter money is under consideration.
- Commodity producers remain under duress, although the most intense effects on real activity may now be past.
- The RBA cut its cash rate to a new low to address a persistent inflation target undershoot. It may fall further.
- India could well remain the best-performing BRIC, although RBI Governor Rajan's resignation is a blow to confidence.

Bottom line: Japan is reaching the end of the monetary policy road; EM growth is too credit dependent for comfort.

Watch for: China and other Asian financial traumas; a continued bias towards looser macro policy; protectionism. ■

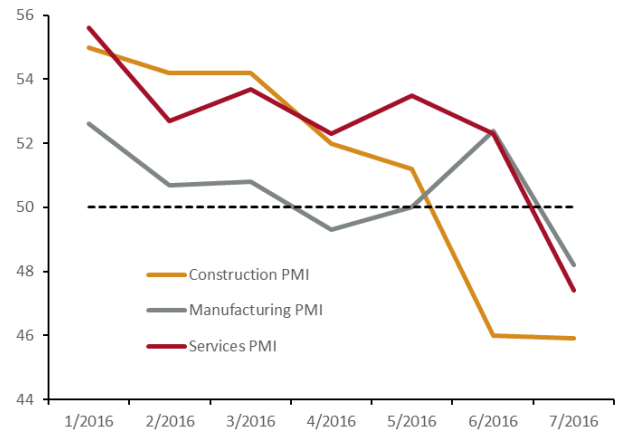
Charts of the month

Figure 1: US real GDP growth, q-o-q, SAAR



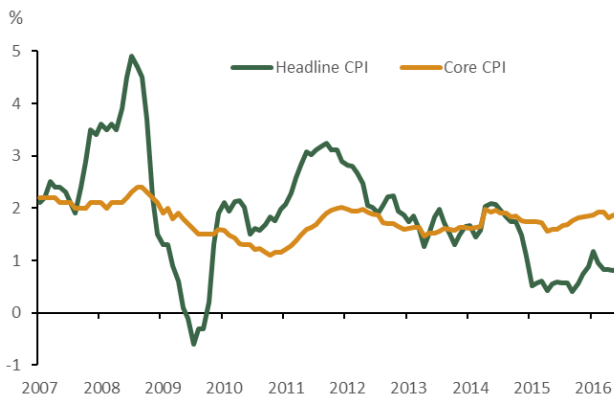
Source: Macrobond

Figure 2: UK PMIs



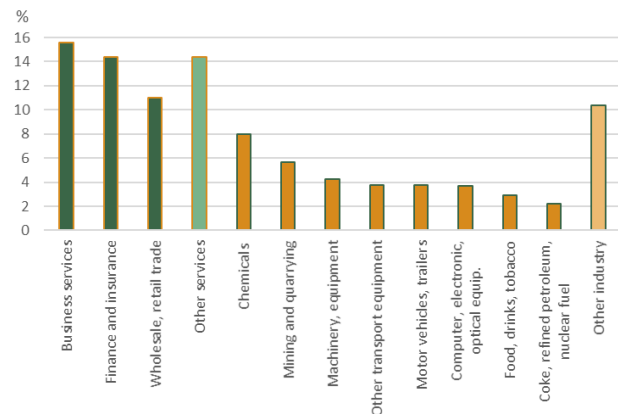
Source: Macrobond

Figure 3: OECD headline and core CPI inflation



Source: Macrobond

Figure 4: UK domestic value added in gross exports, % of total



Source: OECD

Recommended reading

IMF, 2016. *World Economic Outlook, July 19 update.* International Monetary Fund. [link](#)

IMF, 2016. *2016 External Sector Report.* International Monetary Fund. [link](#)

Delong, B., 2016. *A Brief History of (In)equality.* Project Syndicate. [link](#)

Borio, C. and Zabai, A., 2016. *Unconventional monetary policies: a re-appraisal.* BIS Working Paper no.570. [link](#)

Haldane, A., 2016. *Whose Recovery?* Bank of England. Text based on a speech in Port Talbot, Wales 30 June 2016. [link](#)

Subbaraman, R. and Loo, M., 2016. *Asia's Maturing Financial Cycle.* Nomura Global Markets Research.

🐦 **#EconomicRisks** An uninspiring global outlook, populism breeding protectionism, and monetary unorthodoxy giving way to fiscal activism.

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