The Economics of Disruption

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The Economics of Disruption

**Business Cycle Disruptions**

Changes in the dominant growth drivers can have significant implications for the speed, quality and global synchronicity of growth cycles.

**Political Disruptions**

Elections, referenda or changes in government can lead to serious fundamental trend changes, but more often political disruption are merely noise.

**Policy Disruptions**

Sudden monetary or fiscal policy changes can significantly change the direction or amplify the prevailing growth trajectory.

**Productivity Trend Disruptions**

Technological changes, sudden shocks or agglomerations over time, can significantly change the fundamentals of an industry or sector.

How Disruptions affect the Economic Outlook
Rising trend in political risk assessment, but muted market impact under ‘quantitative easing’

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
US tax reform not a game-changer, but maybe an amplifier

Proposed US tax reform fairly evenly split between individual and corporate tax cuts

US national accounts data shows declining tax/profit ratio and rising profit/GDP ratio

CBO estimates for current budget deficits and debt/GDP ratios show no room for tax cuts

Goldman Sachs estimates economic effects of proposed tax reform using the Fed’s macro model

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Business Cycle Disruptions
Closing output gaps evidence of regime shift from world of excess supply to greater supply and demand balance

US output gap has closed reflecting the absorption of excess supply in recent years

US investment suffered recession in 2016, cyclical rebound is amplifying closing output gap effect

Business investment rebound boosted export demand in traditional exporters like Asian Tigers

Stronger capital goods manufacturing has boosted demand and prices for industrial metals

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
The latest regime shift has mainly benefited developed world economies and manufacturing more than services.

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Policy Disruptions
Synchronizing growth trends have also prompted normalization in inflation rates.

Key Developed World Consumer Price Inflation Rates

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Developed world rate hike cycle has started, but emerging markets still in monetary policy easing trend

Central Bank Policy Rates in key Developed World and Emerging Markets

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Fed started balance sheet reduction, ECB made second taper step, but global QE will continue to increase in 2018.

**Global Central Bank Balance Sheet Growth in % of GDP**

Productivity Trend Disruptions
Dramatic productivity slowdown after great recession major disruption for growth and monetary policy

US Productivity trend has undergone several disruptions, still waiting for signs of rebound

OECD productivity has been less cyclical, but recent disruption looks all the more dramatic

Low productivity growth combines with slower labor force growth to depress potential growth rates

Lower productivity growth is also the driving factor behind sharp decline in real US neutral policy rates

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Secular technology hold promise to boost underlying growth and productivity, but will take time

World-wide operational stock of industrial robots

Source: IFR World Robotics 2017
Global Economic Forecasts
And finally .... The most important forecast for the next few year is the growth trajectory in China.

China Economic Activity Index points to slowing growth momentum.

Global Economic Outlook 2018 and Beyond

North America
2017 (e): 2.3% 2018 (e): 2.7%

Latin America
2017 (e): 1.4% 2018 (e): 2.1%

Middle East/Africa
2017 (e): 1.3% 2018 (e): 2.4%

Europe
2017 (e): 2.4% 2018 (e): 2.3%

Asia
2017 (e): 5.7% 2018 (e): 5.6%

Global GDP Growth: 2017 (e): 3.6% 2018 (e): 3.8%

- Faster growth expected
- Neutral growth expected
- Slower growth expected

Source: Thomson Reuters Datastream, Bloomberg, PineBridge Investments Calculations as of 22 November 2017
Global Outlook – Cyclical rebound in business investment should make 2018 the best year in the current global business cycles

**North America**
- US growth acceleration is driven by stronger business investment, robust consumption
- Fed will continue gradual rate hike policy, but at a slower pace compared to its own forecast
- Increasing supply side constraints should pare back growth acceleration after 2018
- Canada has joined US in rate hike cycle, growth outlook clouded by NAFTA risk

**Europe**
- Eurozone continues to benefit from cyclical job growth and now surging export demand
- ECB maintains stimulative policy, but latest taper decision points to end of QE in 2019
- Similar to US, growing supply constrains will pare back growth in next few years
- UK growth outlook has deteriorated sharply as acrimonious Brexit talks point to no deal

**Asia**
- Japan lacks cyclical domestic growth drivers, but benefits from stronger export demand
- Post 19th Congress China to shift focus to deleveraging and environmental challenges
- Tigers benefit from stronger manufacturing activity, but are vulnerable to weaker China
- Central banks in Australia and New Zealand next to join Federal Reserve in rate hike cycle

**Emerging Markets**
- Latin America dominated by recovering Brazil, and trade-threatened Mexico
- Eastern Europe benefits from stronger global growth and robust domestic fundamentals
- Emerging Asia mostly driven by domestic demographics and economic reforms
- Middle East dominated by geopolitical risk, Africa benefits from commodity price rebound

Outlook 2018: Global Business Cycle is Hitting Full Stride
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