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Global Macro 360

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Weekly Note: Looking to 2018

04-December-2017

Market participants are familiar with the annual ritual of year-ahead outlooks, eliciting responses ranging from genuine anticipation ("what's your highest-conviction view for next year?") to ennui ("+100 pages to tell me nothing's new?").

TABLE 1 THIS WEEK IN MARKETS

Name	YTD %	MTD %	WTD %
DOW JONES	19.99%	1.44%	1.21%
S&P 500	16.74%	1.49%	1.22%
RUSSELL 2000	12.24%	1.37%	1.32%
NASDAQ COMPOSITE	28.11%	2.51%	1.56%
Euro Stoxx 50	8.90%	-2.46%	0.12%
FTSE 100	4.45%	-0.43%	0.67%
DAX 30	13.75%	-1.29%	-0.82%
NIKKEI 225	17.64%	2.16%	1.01%
HANG SENG	34.91%	5.08%	-0.46%
S&P/ASX 200	5.62%	1.27%	0.35%
EUR-USD X-RATE	12.88%	1.94%	1.14%
EUR-GBP X-RATE	-4.90%	-2.32%	-1.21%
Gold Spot $/Oz	12.93%	1.92%	1.20%
Crude Oil	7.69%	6.38%	3.14%

No one should expect market drivers to change dramatically across every asset class just because the calendar year advances, but this analyst has always found the exercise useful for rethinking the medium-term framework, questioning core assumptions, and anticipating turning points.

For what it's worth here are some very broad thoughts:

For the global economy, 2018 involves both continuity and change. Continuity comes following a second-consecutive year of above-trend expansion, due to the positive feedback from growth to both financial conditions and sentiment. Business should be the sectoral leader as their profits revival motivates stronger capex, while consumer spending will moderate due to oil's previous rise. Chinese growth also eases due to previous credit tightening.

Change comes from an inflation upturn and the resulting central bank response. Commodity prices are already lifting headline CPI, but tightening DM labour markets should also push up core markets (US to 1.8%, Euro area and Japan to about 1%). Hardly high inflation, but good enough to motivate policy changes from very accommodative settings.

We expect five Fed hikes between now and end-2018, another ECB tapering in September, and hikes in the BoJ's 10-year yield target in H2. (US fiscal easing is assumed, but matters more for corporate profits than for growth, inflation, or Fed policy.)

This policy backdrop carries material consequences for fixed income, given serious valuation problems in some bond markets (Bunds, JGBs) and tighter-than-average spreads in US, European and EM corporates. Although there is no commonly accepted definition of a bear market in bonds (unlike the -20% metric used in equities), 2017 was a losing year for German Bunds (-0.8%) and almost for JGBs (+0.2%). In 2018, losses probably broaden from Bunds to other DMs, in turn imposing flat or negative returns on some credit sectors.

The trade-weighted dollar shouldn't have much trend over 2018 – we forecast it broadly higher in Q1/Q2 due to the Fed hikes alone, then lower in H2 as focus turns to ECB and BoJ tapering plus late-cycle Fed fatigue sets in. We wouldn't make much of the USD/commodity correlations in a year like 2018 when both might only move to low single-digits.

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