ECONOMIC VIEWPOINT

A Global Recession on the Horizon? Signs Are Still Scarce

The global economy has been going through a difficult time since early 2018. Most noticeable is the anemic world trade and the problems in the manufacturing sector. Yet, could these weaknesses be an indication of more serious and more widespread problems? In other words, could we be heading towards a new global recession? According to an analysis grid of economic indicators for most of the G20 countries, few economies are showing signs of a contraction. Still, among advanced countries, Germany and Japan as well as the United Kingdom (in the event of a hard Brexit) need to be watched closely. Among the emerging economies, the overall impression is rather dark in terms of manufacturing, but consumers are showing some resilience. The global situation on the whole is more fragile than it has been in several years, but a worldwide recession does not appear to be taking shape.

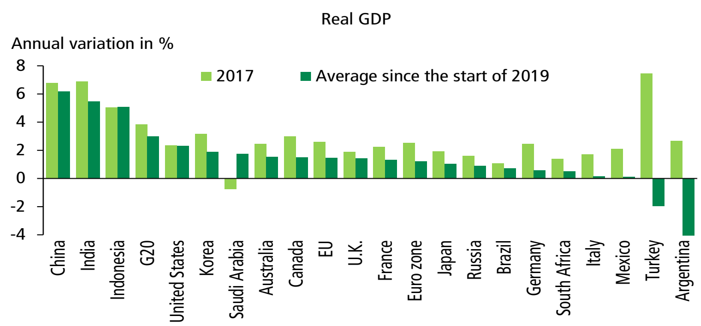
The Global Economy Is Slowing

Global real GDP reached 3.8% in 2017, its biggest gain since 2011. Then, there was a slight slowdown in 2018 (3.6%), which, according to our base scenario, should worsen in 2019 (3.1%) and 2020 (3.0%). The Managing Director of the International Monetary Fund (IMF) recently described the current economic situation as "a synchronized slowdown." She added that the IMF expects growth to decelerate in nearly 90% of the global economy. This contrasts with the previous situation. According to the IMF, "Two years ago, the global economy was in a synchronized upswing. Measured by GDP, nearly 75 percent of the world was accelerating." Graph 1 shows the slowdown in growth among the G20 countries between 2017 and the first three quarters of 2019. The two worst cases, i.e., Turkey and Argentina, are countries in the midst of a major economic crisis. Among the countries in which the difference between 2019 and 2017 is especially huge, are two of the three main European economies, i.e., Germany and Italy. In the latter's case, it's the political and financial imperatives that pose a problem. As for the German economy, it's the general problems of global trade and the global manufacturing sector that seem to be affecting it. All that remains to be seen now is just how low the global economy will trend. Will it reach the point where the slowdown morphs into a recession?

Global Recessions

Global recessions are rare. They require a large number of national economies, especially the biggest ones, to undergo a widespread, synchronized contraction.

GRAPH 1
Most of the G20 countries have seen their economic growth slow



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

There is no precise definition of what a global recession is. In the United States and Europe, independent organizations[1] are issuing start and end dates for economic cycles based on several criteria, such as the change in real GDP or its components, or indicators like employment, industrial output, income and sales.

In its economic commentary, the IMF has sometimes mentioned a growth rate in global real GDP below which the global

[1] The National Bureau of Economic Research (NBER) in the United States and the Center for Economic Policy Research (CPER) in the euro zone.

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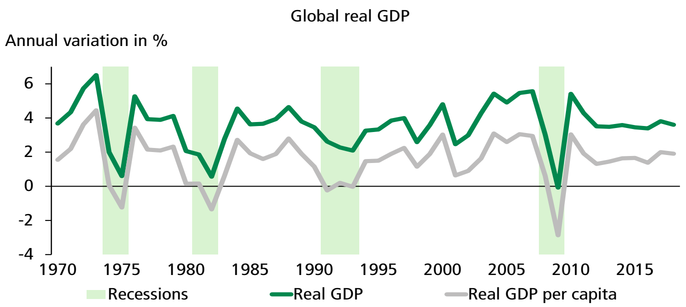
economy can be considered to be in a recession. This rate is not zero, and real GDP doesn't necessarily have to be contracting to indicate a recession. That's because the rapid population growth in emerging or developing countries must be taken into account. Therefore, a recession would best be described as a net decrease in real GDP per capita (graph 2), but this indicator is seldom used—this is when a real GDP rate comes in. Historically, the IMF referred to 3.0% growth of global real GDP as the threshold between a recession and an ongoing upward cycle. Since the crisis of 2009 (during which even real GDP contracted), 2.5% is usually mentioned. Furthermore, the IMF's chief economist recently reiterated the 2.5% threshold. Neither our scenarios nor those of the IMF suggest growth will drop below the recession threshold.

GRAPH 2
Real GDP growth per capita helps identify the real contractions in the global economy



Sources: Datastream and Desjardins, Economic Studies

Indicators of a Recession

Knowing whether or not the global economy, or a national economy, is in recession requires more than just looking at the change in real GDP. As explained, the National Bureau of Economic Research (NBER) looks at the movements of several indicators before officially stating whether the United States is in recession or not. Also important is looking at which signs provide a heads-up as to when an economic cycle has reversed. Therefore, it is helpful to use a full array of indicators to determine the health of the economy.

The table shown in appendix summarizes several variables that are generally indicative of a recession in most of the G20 countries. There are the variations in real GDP, labour market indicators, business activity and consumer confidence indicators, the OECD leading indicator and variables concerning economic activity (production, sales, construction and exports) as well as stock market changes.

Several indicators are pointing to a deteriorating economic situation, but the weaknesses are concentrated. As a result, most countries are posting a PMI manufacturing index below 50 and negative annual variations in consumer confidence, the OECD leading indicator, exports and industrial output. This observation is compatible with a deteriorating economic situation caused by the trade tensions, which are affecting manufacturing more. In addition, there is a feeling that these concerns are starting to have a negative impact on consumer confidence.

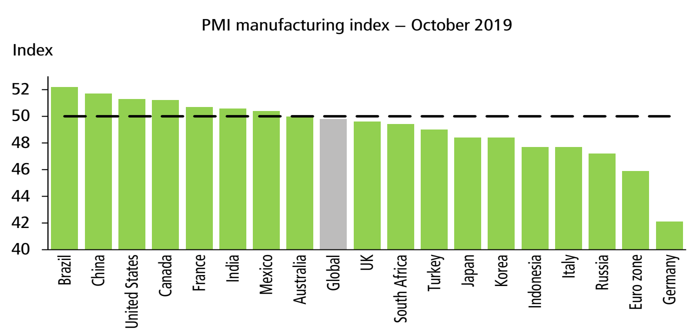
Let's look more closely at the change in the economic situation and the risk of a recession for the major economies (excluding the United States and Canada, which will be discussed in subsequent publications).

Euro Zone: Germany Narrowly Avoided a Recession, but France Is Doing Well

Economic growth has clearly slowed in the euro zone. After a strong 2017 during which euro zone's real GDP grew 2.7%, gains have fallen to 1.9% in 2018, then 1.1% on average in the first three quarters of 2019. Does this slowdown threaten to become a true recession? Several indicators are clearly heading down, yet, for most of the economies, consumer spending appears to be holding its own. Were the PMI services to fall below the 50 threshold and consumer confidence abruptly drop, these would be signs of a more serious deterioration of the economic situation, requiring close monitoring of these indicators in the months ahead.

A major part of the weak euro zone figures is due to German indicators. The annual variation in Germany's real GDP is anemic, and it narrowly avoided a second consecutive quarterly decrease and thus a technical recession. The decline in industrial output and exports and the low PMI manufacturing index (graph 3) were convincing signs of these troubles.

GRAPH 3
Germany still has the lowest PMI manufacturing index



Sources : Datastream, IHS Markit and Desjardins, Economic Studies

For its part, France is doing rather well, as the table shows that only three of the listed indicators are falling. Of particular note is that French industry is less affected than German industry. This resilience is such that the likelihood of a recession in the short term seems relatively small. In Italy, the political problems and uncertainty already led to a technical recession in mid-2018, and growth remains very weak, which is reflected in several indicators. Consumer confidence and retail sales are also noticeably down. Under these circumstances, a return to negative territory can't be ruled out entirely.

United Kingdom: Everything Still Depends on Brexit

A majority of British indicators are negative. Real GDP had already fallen 0.9% (annualized) in the spring, followed by a 1.2% gain, thereby eluding a technical recession. This unforeseen turn of events is mostly due to the issue of Brexit and business preparations given the various (postponed) deadlines. All that remains now is to see if the election on December 12 will lead to greater clarity for households and businesses. A no-deal Brexit (which would be surprising given the political developments) at the end of January 2020, i.e., when the current extension ends, is one factor that could lead to a recession in the United Kingdom. As would a hard Brexit (with no major free-trade agreement), which would worry businesses and households at the end of 2020, i.e., after the transition period negotiated between the European Union and the United Kingdom.

Japan: Frequent Recessions

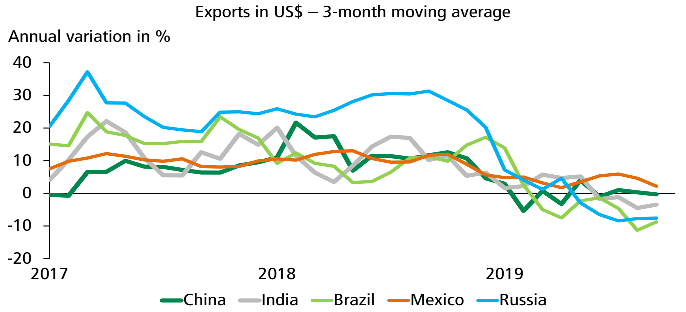
With very little potential for growth, real GDP suffers a setback more often in Japan than in the other advanced economies. GDP growth was, nonetheless, relatively good in recent quarters. Still, the trade war and Chinese slowdown also hurt the Japanese economy, as seen in the weak PMI indexes. However, the current indicators are affected by the October 1st consumption tax hike. The figures that preceded this hike benefited from purchases being moved up, while those that followed are starting to show signs of a significant retreat. Real GDP threatens to fall in Q4.

Emerging Economies: Several Signs of Weakness and Significant Regional Disparity

Emerging countries are also showing signs of weakness. Uncertainty surrounding trade policies is elevated, and the introduction of U.S. tariffs, aimed mostly at China, has slowed down manufacturing, which is declining in several countries. The resistance of Russia's industrial sector, which is growing roughly 3% annually, is mainly due to government support. China's and Brazil's PMI manufacturing indexes have improved, helped, in part, by the depreciation of their exchange rates compared with the dollar, indicating that the industrial sector could stabilize.

Needless to say, exports have also dropped (graph 4). Russia and Brazil were especially hard hit, as both depend heavily on China, and Argentina, a major buyer of Brazilian goods, has been in a recession since 2018. The climate of uncertainty surrounding the global economy has also pounded investment, especially in Mexico and India, which are dealing with serious domestic problems.

GRAPH 4
Exports from the main emerging countries have slowed considerably

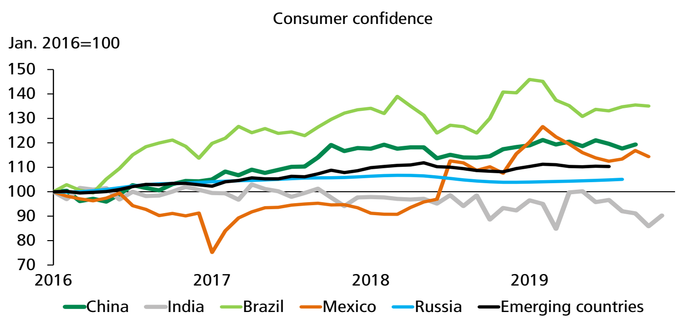


Sources: Datastream and Desjardins, Economic Studies

Consumers, for their part, still seem fairly resilient. Retail sales in China have moderated, but annual growth remains strong at over 7%. After two extremely negative years, Brazilian consumers have finally regained some strength. Retail sales are currently growing at a lower rate than in 2018, but remain steady all the same.

Consumer confidence indexes in the main emerging countries continue to be fairly high (graph 5) and have generally deteriorated less than in advanced countries. However, India is a case apart as its consumers are at a disadvantage due to the problems with the banking system and a struggling labour market.

GRAPH 5
Consumers in emerging countries remain relatively optimistic



Sources: Datastream and Desjardins, Economic Studies

Overall, the situation of emerging economies is not all that different from that of advanced countries and, in some cases, the economic situation appears to be even better, although fragile. Still, the main emerging countries are also at the mercy of the developments involving trade and the global economy. Recently, political instability has made its way into some emerging countries as protests flared in many Latin American, Asian and Middle Eastern countries. Civil unrest has been ongoing for many days now and in some cases there have been violent confrontations. Should this instability persist, there could be a significant impact on these countries' economy.

Conclusion

There are a number of weak areas within the global economy. Still, they can largely be traced back to the same source: the trade tensions caused by the rise in protectionism. Clearly, it is mostly specific factors associated with manufacturing and exports that are problematic.

A certain global dependence on extremely low interest rates has also led to the current economic cycle being somewhat fragile. This effect grew in importance in the United States, where the rise in interest rates not only had domestic consequences, but also international ones, especially for the emerging countries.

As long as consumers are demonstrating a certain resilience in advanced and emerging economies, a global recession should be avoided. Consumer confidence indexes, which have peaked and begun to slip, suggest, however, that the battle is not yet won.

Furthermore, given their economic weight, which represents approximately one-third of global GDP, a global recession requires that the cycle end in the United States and in China, something that is not part of the base scenario despite the trade war between the two countries.

Also important to remember is that public authorities can react to different signs of weakness. Despite the lack of clear signs of a recession, several central banks have already adopted a preventive management approach in their monetary policy and have even eased it. Governments can also react, as was seen in China (with no spectacular results, however). The Japanese government also seems to want to move forward by adopting an expansionary budget policy.

That being said, striking a long-lasting truce in the trade wars and calming the related uncertainty would, in all likelihood, be the best way to give the global economy a boost. Conversely, if the tensions were to become even more acrimonious, more indicators could deteriorate, signalling that the global economy may be even closer to the end of the current economic cycle, which began in 2009.

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TABLE

Summary of variables indicative of a recession

	WEIGHT IN GLOBAL GDP	QUARTERLY INDICATORS		MONTHLY INDICATORS										
		National accounts	Labour market	Labour market	Activity indicators			Other economic indicators						Stock market
ANNUAL VARIATION IN % (EXCEPT IF INDICATED)	%	GDP	Employment	Unemployment rate (% points)	PMI manuf. (level)	PMI services (level)	Cons. confidence	OECD leading ind.	Exports	Industrial production	Housing starts	Retail sales	Car sales	
Country or economic regions														
United States	15,2	2,0	1,2	-0,2	51,3	50,6	-8,7	-1,7	-2,7	-1,1	8,5	3,1	-11,7	7,7
Canada	1,3	1,6	2,3	-0,2	51,2	n/a	-7,7	-1,1	-2,0	-1,5	-5,3	1,1	-5,1	9,7
Euro zone	11,7	1,2	1,2	-0,5	46,6	51,5	-0,3	-1,3	-3,6	-1,9	7,5	3,1	9,8	12,7
Germany	*3,3*	*0,5*	*1,2*	*-0,1*	*42,1*	*51,6*	*-0,8*	*-2,1*	*-4,1*	*-5,3*	*6,8*	*3,5*	*12,7*	*12,4*
France	*2,3*	*1,3*	*0,3*	*-0,5*	*50,7*	*52,9*	*1,0*	*-0,4*	*-5,6*	*0,1*	*-2,0*	*3,9*	*6,6*	*6,9*
Italy	*1,9*	*0,3*	*0,3*	*-0,5*	*47,7*	*52,2*	*-4,0*	*-1,2*	*-1,3*	*-2,1*	*n/a*	*1,7*	*6,7*	*16,8*
United Kingdom	2,2	1,0	1,3	0,7	49,6	50,0	-0,5	-0,9	-9,0	-1,4	n/a	3,2	-6,7	2,3
Japan	4,3	1,4	1,0	0,0	48,4	49,7	-15,6	-0,9	-0,8	-0,3	-4,9	9,2	-27,5	1,3
Australia	0,9	1,4	2,5	0,3	50,0	50,1	-7,0	0,4	10,5	1,9	-9,4	2,5	-9,1	14,3
South Korea	1,5	2,0	1,4	-0,4	48,4	n/a	-0,6	-1,2	-13,1	0,7	n/a	1,3	2,2	2,7
Brazil	2,5	1,0	-1,5	-0,1	52,2	51,2	3,8	0,6	-16,8	0,6	n/a	4,6	4,5	22,6
India	7,4	5,0	n/a	n/a	50,6	49,2	-3,3	-1,3	-6,6	-4,3	n/a	n/a	0,3	12,5
China	18,3	6,0	n/a	-0,2	51,7	51,1	4,7	0,1	-5,5	4,7	n/a	7,1	-5,8	12,5
Russia	3,0	0,8	-1,0	0,0	47,2	55,8	0,2	-1,1	-11,2	3,0	10,2	5,4	-5,2	23,0
Mexico	1,8	0,3	2,2	0,2	50,4	n/a	3,6	2,6	-3,4	-2,0	n/a	2,4	-16,4	-1,4
Argentina	n/a	-1,8	3,7	1,0	n/a	n/a	34,1	n/a	13,7	-3,0	-16,7	51,1	-26,9	17,2
Indonesia	2,5	5,0	n/a	n/a	47,7	n/a	-0,7	0,7	-6,2	4,5	n/a	0,8	-9,5	1,0
Turkey	1,7	-1,4	-2,8	2,9	49,0	n/a	15,2	3,5	-2,5	2,9	-48,2	11,4	16,0	10,7
South Africa	0,6	0,8	1,4	1,6	49,4	n/a	-1,9	-0,5	-5,6	-2,7	n/a	3,7	2,4	1,2

PMI: Purchasing Manager's Index; OECD: Organisation for Economic Co-operation and Development; n/a: not available
NOTE: Last available data for each indicator. Green cells indicate a negatif signal.
Sources: Datastream and Desjardins, Economic Studies