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Global growth, the French election, and the Fed

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Last week was another busy, momentous one. Below, we discuss three key topics: global growth, the French election, and the Federal Reserve's hawkish comments.

Growth expectations fall for the globe

Not surprisingly, the International Monetary Fund (IMF) downwardly revised growth expectations due to Russia's invasion of Ukraine and the consequences. The IMF now expects 2022 global growth of 3.6%, rather than the 4.4% it projected back in January, and it also expects 3.6% global growth in 2023.[1] Drilling down into developed and emerging economies, growth expectations for developed economies were lowered to 3.3% in 2022 and 2.4% in 2023, down from January's forecast of 3.9% in 2022 and 2.6% in 2023.[1] Expectations for emerging economies were also downgraded to 3.8% in 2022 and 4.4% in 2023, from 4.8% in 2022 and 4.7% in 2023; however, this suggests a solid re-acceleration in growth in 2023 for emerging economies.

Russia's invasion of Ukraine also caused the IMF to increase its inflation projections to 5.7% in developed countries and 8.7% in EM countries, which is 1.8 and 2.8 percentage points higher, respectively, than January 2022 inflation projections.[1]

However, the big news is around China and concerns about its growth. The IMF downgraded its estimate for China's 2022 growth to 4.4% from 4.8%[1] amid fears that Beijing will see lockdowns given a spike in COVID infections. Obviously concerns are growing about China's ability to deliver anywhere near the official target of around 5.5% given the COVID lockdowns. Recent news of the variant spreading into China's capital city and the resulting lockdown of an area on the eastern side of the city have led to domestic market jitters. Local residents in the area have been asked to stay at home until April 27, until two mandatory mass COVID tests have been completed.

It is clear that in March, COVID lockdowns impaired consumption, and that situation is only getting worse. In this environment, I wouldn't be surprised to see China's second-quarter gross domestic product (GDP) disappoint. However, that does not change my far more positive view of the back half of 2022, when we expect a rebound from COVID and more policy support, which should lead to strong growth in the second half of this year. That may not get us to 5.5% growth for the year, but it is likely to keep growth above 4.5% for the year. Furthermore, a second-half mid-cycle acceleration in China would also point to the potential for stronger growth going into 2023 – which would jive with the IMF's view of a re-acceleration of broader emerging markets growth in 2023, given strong trade links between China and many other emerging market countries.

Market sentiment in China is understandably weak since the economy is facing many headwinds that have led to weak first-quarter earnings. However, domestic investor sentiment could be nearing a bottom. Looking at the recent trading data, the A-share average daily turnover rate was only 1.2% last week and margin trading is at significantly lower levels now compared to 2018's rout.[2] In addition, valuations are looking increasingly attractive.

Macron secures victory in France

Other big news of the week is not about the economy or markets – it's about the French elections. Despite market concerns that Marine Le Pen would win in the second and final round of the presidential election, Emmanuel Macron was able to pull off a victory, with a spread that was wider than expected. I expect this to reduce fear and volatility in European markets, although a victory had already become priced in in recent days so there has been no "Macron bounce." I think the takeaways are significant. This can be viewed as a victory for the European Union and NATO despite real consumer pain due to high inflation.

So for the time being, this election represents the maintenance of the status quo. Where there is more interest (and the potential for change) is the upcoming legislative elections (June 12 and 19). At the moment, Macron's La Republique en Marche party holds 312 out of 577 National Assembly seats, hence Macron has been working with a friendly Parliament and has been able to appoint a prime minister from his own party, which has enabled him to realize more policy objectives, including economic reforms.

Given the presidential election results, with the success of the far-right and the far-left, it is possible that the legislative elections will be less clear cut this time. Recall that in 2017, Macron and his party were surfing a wave of enthusiasm; that is far from the case now, with many electors either abstaining during the second round of votes on Sunday or reluctantly voting for Macron to avoid a Le Pen presidency. Those dissatisfied voters may see the parliamentary elections as a way to deliver a rebuke to Macron without running the risk of an extreme change in leadership at the top.

Hence, the French Parliament could now be more fragmented, with the possibility that Macron has to choose a prime minister from outside his own party. If that is the case, we need to remember that the president controls defense and foreign policy, with the PM controlling domestic policy. For example, Lionel Jospin was a Socialist PM during the presidency of Jacques Chirac, and he's the one who introduced the 35-hour work-week. A PM from the far-right or far-left could introduce a more expansive budget, in which case bond spreads versus Germany may widen and French equities may underperform. However, the key question of European Union (EU) membership would not be in question, as that is under the president's control. There is an expectation on the international front that Macron will spearhead the further integration of Europe, stepping into Angela Merkel's shoes. He already was instrumental in the debt mutualization behind the Recovery Fund and the long-term success of the euro is likely to depend on further fiscal integration of the member states. Macron is also committing to further defense spending and has been a proponent of greater cooperation in the EU on this matter. This should help to maintain market stabilization, in our view.

Taking a step back, we have to recognize that the establishment of En Marche in 2016, Macron's centrist party, reshaped the political landscape in France. It effectively meant there are three voting blocs: far-left, center, and far-right. The traditional center-left and center-right parties have fallen away, being replaced by En Marche over the past six years. That creates a vacuum of eligible market-friendly candidates for the next election in 2027. Macron cannot run again, but Marine Le Pen can and probably will run (despite her protestations to the contrary). Having just registered a vote of 41%[3] (the highest ever for a candidate from the far-right), she must be encouraged to believe that she is just one more push away from the presidency, especially if no other charismatic candidate from the center reveals themselves.

The Fed spooks markets

Also last week, markets were spooked by hawkish comments from the Federal Reserve (Fed). On Thursday, not only did Fed Chair Jerome Powell say that a half-point interest rate increase will be “on the table” when the Fed meets in early May, but he suggested there could be half-point hikes at the next several meetings, explaining “We really are committed to using our tools to get inflation back” to more normal levels.[4] He made it clear that, “We are going to be raising rates and getting expeditiously to levels that are more neutral,”[4] and then higher if needed. St Louis Fed President Jim Bullard was even more hawkish in his comments last week.

In our view, markets should not fear these aggressive comments but should welcome them; hawkish talk can help do the heavy lifting for the Fed and, in my opinion, shape consumer psychology around inflation. This is how the Fed – and other central banks -- can potentially orchestrate a soft landing and avoid a recession.

With contributions from Paul Jackson, Arnab Das, Emma McHugh and David Chao

Notes

[1]International Monetary Fund, World Economic Outlook, April 2022

[2]Bloomberg, as of 4/22/22

[3]CNBC, “Macron has won France’s presidential election. But the far right is upping its game,” April 25, 2022

[4]Yahoo Finance, “Fed's Powell, half-point hike in view, completes hawkish pivot,” April 21, 2022

Important information

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All investing involves risk, including the risk of loss.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Gross domestic product is a broad indicator of a region’s economic activity, measuring the monetary value of all the finished goods and services produced in that region over a specified period of time.

A-shares are issued by publicly listed Chinese companies and trade on Chinese stock exchanges.

Share turnover reflects the liquidity of a market by dividing trading volume over outstanding supply for a given period.

The International Monetary Fund is an international organization that works to ensure the stability of the international monetary system.

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