The global economy: Super bad or super strange?

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What is super bad?

The Russia-Ukraine war, the price of oil, and recession risks in the UK and Eurozone top my list of what’s bad in the global economy.

What is far from super bad?

I would put several items on this list, including US employment, tariff reductions, and an easing of COVID lockdowns in China.

Is the global economy really that terrible?

Last week saw some real doom and gloom coming from the mouths of CEOs, one of whom famously shared that he has a “super bad” feeling about the economy. As the mother of teenage boys, I’m extremely familiar with the term “super bad” as it’s the name of a sophomoric movie that they absolutely love. For them, “Superbad” is one of the best movies of all time. But it’s not a term we want to see associated with the economy.

So is the global economy super bad? In my opinion, definitely not. I think it’s more appropriate to describe it as “super strange” – I continuously hear financial professionals and clients tell me that they are not sure what to make of it, that it is such an unusual environment. One simply said, “it is tough to get comfortable in this environment.” I believe some aspects of the global economy are very positive while some are very negative. And sentiment is very negative — surprisingly so, in my opinion. Let’s go through what’s working and what isn’t right now.

What is super bad?

1. **Russia-Ukraine war.** Russia is making some gains, even attacking Kyiv again. This war is worsening slightly and becoming increasingly entrenched, which is bad news for the world in terms of possible food shortages as well as scarcity of certain commodities, leading to supply chain disruptions and higher costs. And the risk of an energy cut-off remains a substantial threat to the European economy.
2. **The price of oil.** Crude oil prices have risen significantly in the past five weeks. Energy prices have a way of cascading through the entire economy, increasing so many other prices. In the US, the national average price for a gallon of gas reached $4.85 this week, which is about double the price at the start of 2021.[1] While energy prices remain elevated, we are very unlikely to return to central banks’ target inflation rate of around 2%.
3. **Recession risks rising in the UK and Eurozone.** The UK and Eurozone economies are greatly affected by the Russia-Ukraine war. They are weaker and at a greater risk of recession. And their respective central banks have a more delicate balancing act as they try to control high inflation, especially since they cannot solve for some of the key sources of inflation.

What is far from super bad?

1. **The US employment situation.** There was a lot of focus on how “good” the May jobs report was, and stocks had a “good news is bad news” reaction on Friday because US job creation was so high. However, I believe the most important part of the jobs report right

now is wage growth, and that showed a welcome slowing. Average hourly earnings rose 0.3% month over month, which was below expectations of 0.4%.[2] And so wage growth was relatively benign in May, as it was in April, suggesting the more "sticky" part of inflation — wages — may not be so problematic.

Thus far, the employment component of the US Federal Reserve-orchestrated slowdown is going according to plan. By that, I mean that the Job Openings and Labor Turnover Survey (JOLTS) report for April, released last week, showed that the number of job openings had decreased, but we have yet to see a pickup in layoffs (in fact, layoffs decreased). I am hopeful this could continue, with little in the way of layoffs but a significant decrease in job openings, which could certainly help to alleviate wage pressures going forward.[3] In my view, this is how the US can achieve a soft landing.

2. **Market-based inflation expectations have fallen in recent weeks for the US, Germany and the UK.**[4] Despite high energy prices, there have been some indicators encouraging the view that inflation should start to moderate soon. In addition, I also believe major Western central banks have been able to maintain some credibility with relatively tough talk about fighting inflation. As we have seen since the Fed's hawkish pivot earlier this year, its words have done some of the work without much in the way of actual rate hikes, causing a tightening of financial conditions. This in turn has helped shape inflation expectations. So don't fear tough talk from the Fed or other central banks.

3. **COVID stringency rollback in China.** Economic data has been very disappointing in China in the past several months, given COVID lockdowns. However, that should start to improve given the lowering of stringency in major cities. Last week in Shanghai, fences began to be dismantled, public squares were re-opened, and public transportation resumed. Employees are returning to work and things are getting back to normal. This should help improve supply chain disruptions, which have been a significant source of inflation. We already saw a slight improvement in Purchasing Managers' Indexes (PMI) last week, and I believe that will continue – especially as fiscal stimulus kicks in. The story unfolding in China is very positive, although it could take a little time to gain momentum. (Of course, the downside is the potential for higher energy prices as oil demand increases, but I believe the benefits of re-opening far outweigh the disadvantages.)

4. **Tariff reductions.** This past weekend, US Commerce Secretary Gina Raimondo said the Biden administration is considering a roll back of some Trump-era tariffs. The Biden administration announced on June 6 that it will suspend tariffs on solar panels from some southeastern Asia countries.[5] It seems the administration is focused on rolling back tariffs related to the energy industry, given high energy costs, but I am optimistic it could extend beyond this as they look for any possible ways, however small, to tamp down inflation. This is also a small victory for globalization.

5. **Signs of regulatory easing in China.** There are reports that Chinese authorities' investigations into several Chinese companies are ending, and that suggests that the Chinese regulatory

environment in general might be improving. This certainly supports what has been communicated by Chinese policymakers in recent months about becoming more business-friendly. This should also be a positive for the Chinese economy.

Conclusion

What are the key takeaways? Some parts of the global economy are in poor shape, but other parts are definitely not. Some companies are benefiting from this environment while others aren't. For example, despite very pessimistic views from some CEOs, we have also heard more positive observations and views. For example, last week Hewlett Packard reported better-than-expected earnings and revised its guidance upward for the rest of the year. Delta Airlines CEO Ed Bastian said "the demand is off the charts."[6] This is something we have heard from other airlines as well; and while they are forecasting higher energy costs, they appear to be able to manage them well. And original equipment manufacturer Foxconn anticipated an improved supply chain environment in the back half of 2022.[7]

After years of ultra-accommodative monetary policy creating a rising tide that floated all boats, I believe the current era is one in which we will need to be selective and discerning, focusing on industries and companies that can potentially perform well in this environment.

What to watch

Here are three items I'll be watching in the coming week:

1. April US Consumer Price Index (CPI) numbers will be an important data release. I expect month-over-month core CPI growth to have moderated in April as tightening financial conditions have already started to cool the US economy.
2. The preliminary University of Michigan consumer survey results will be released. I am particularly focused on consumer inflation expectations, which I am hopeful will have moderated despite rising energy costs.
3. Central bank activity. European Central Bank, the Reserve Bank of Australia, and the Reserve Bank of India are all meeting soon and are in tightening mode. I am interested in their outlook for inflation and their respective economies given this challenging environment.

Notes

[1]Source: American Automobile Association, as of June 6, 2022. [2]Source: US Bureau of Labor Statistics, June 3, 2022. [3]Source; JOLTS Summary for April 2022, released on June 1, 2022, by the US Bureau of Labor Statistics. [4]Source: Bloomberg, as of 6/3/22. [5]Source: Reuters, 6/6/22. [6]Source: Reuters, “Delta, United Airlines sound bullish on post-pandemic spending,” June 1, 2022. [7]Source: Reuters, “Foxconn predicts more stable supply chain in the second half of 2022,” May 31, 2022.

Important information

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

Purchasing Managers Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

The Consumer Price Index (CPI) measures change in consumer prices. Core CPI excludes food and energy prices while headline CPI includes them.

The opinions referenced above are those of the author as of **June 6, 2022**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.