



## *Global growth picks up, but not inflation*

The OECD issued its latest update on the state of the world economy last week. It sounded upbeat, noting that the global economy is now growing at its fastest pace since 2010, with the upturn evident across nearly all countries. It is being accompanied by good gains in employment and falling jobless rates. Furthermore, the stronger growth is expected to be sustained, with the world economy forecast to grow in excess of 3.5% in both 2018 and 2019.

The OECD, though, expects inflationary pressures to remain moderate, despite the pick-up in economic growth. It is projecting that inflation will rise only slightly in advanced economies to just below 2% by end-2019, while inflation is forecast to remain at low levels in most emerging economies.

As a result, monetary policy is likely to remain very loose in all the major economies over the next couple of years. Continuing low inflation has led markets to believe that only limited policy tightening is likely in 2018/19, despite the strengthening of global economic activity. This has seen bond yields remain low in most markets. Meanwhile, many stock markets have risen to either multi-year highs, or have hit new historic peaks, helped by the benign combination of stronger growth but continuing low interest rates.

Growth has been noticeably stronger in the Eurozone this year, but the ECB has decided to continue with its QE asset purchase programme until at least September 2018, given the weak inflationary environment. Furthermore, it has said that it will keep interest rates at their current very low levels well past the time when it stops increasing QE. Thus, it is likely to be 2019 at the earliest before rates are increased in the Eurozone from their current level of -0.4%.

In the UK, the Bank of England recently reversed the 25bps rate cut made in 2016, thereby bringing the bank rate back up to 0.5%. It was the first UK rate hike since 2007. However, further rate increases are not expected for some time. Markets are looking for UK rates to be hiked again at the end of 2018, with another hike priced in by end 2019. This would leave rates at a still very low 1%, which is hard to believe given that the unemployment rate has dropped to 4.3%.

Meanwhile, the Fed hiked rates by 25bps at its December 2015 and December 2016 meetings, the first such rate hikes in nearly a decade. It followed this up with two further hikes in March and June of this year, taking rates to 1.125%.



The Fed is set to raise rates again later this month and is projecting that they are likely to rise to 2.75% by end 2019. Markets, though, are not convinced and expect rates to rise to just 2% by end 2019 because of continuing low inflation, even though the jobless rate has dropped to 4.1%.

In Japan, meantime, the economy has grown for seven straight quarters for the first time since 2001, and would at last seem to be emerging for a prolonged period of stagnation. Inflation, though, remains at very low levels. Hence, there is no expectation that the Bank of Japan will end its QE programme anytime soon, never mind increase interest rates.

The general expectation that inflation will stay subdued is the lynchpin underpinning the market's view that interest rates will remain very low for the rest of this decade. Any deviation from this view would pose a major risk to financial markets given their current elevated levels.

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