Marketplace review

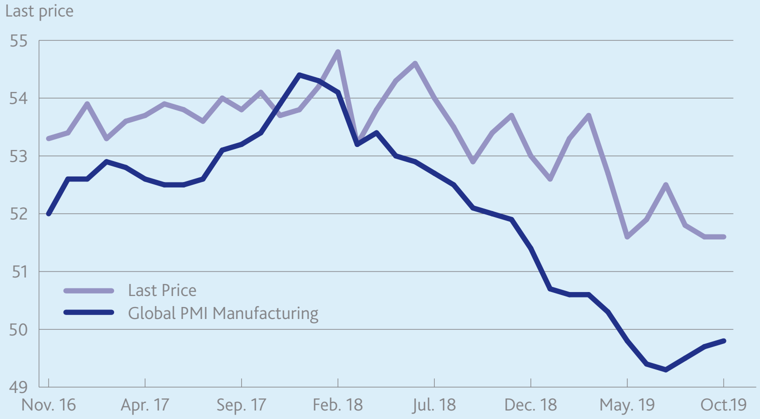
Trade headwinds slow global economy

Saad Rahim,
Chief Economist and Head of Research

Global growth clearly slowed in 2019, as Central Bank easing was insufficient to offset headwinds from the trade conflict between the US and China. Global manufacturing and trade contracted. The US economy remained fairly resilient throughout 2019, but most other major markets were negatively affected to a significant degree. Vehicle sales, a good proxy for the health of the consumer market given the relative cost of a vehicle, fell sharply year on year, as consumers revaluated their economic prospects. As such, we spent much of the year in an environment where we were not making, moving or driving.

Manufacturing and services PMI

Global
Stated as an index (>50 = Expansion)



On top of a late-cycle slowdown, the ongoing back and forth of the trade conflict between the US and China certainly kept markets on edge throughout the year. While equity markets have made new record highs heading into the end of the year, we have also seen the yield curve inverting, normally a harbinger of recession. The fluid nature of the trade talks over the year has meant that businesses have been unable to commit to forward capex plans, while consumers have been buffeted by the fluctuating prospects of higher prices in the near future and thus limited consumption below what it might have otherwise been.

Global Macroeconomic Environment

Perhaps nothing illustrates the shift in macroeconomic sentiment more than the complete reversal Central Banks have made in the space of a few months. As 2018 came to a close, the question was not whether Central Banks would continue tightening but rather by how much they would tighten. Markets were expecting the US Federal Reserve, for example, to raise interest rates at least once if not twice in 2019. Instead, the US Federal Reserve has cut rates three times this year, as concerns around growth proliferated, in large part due to the trade war uncertainty.

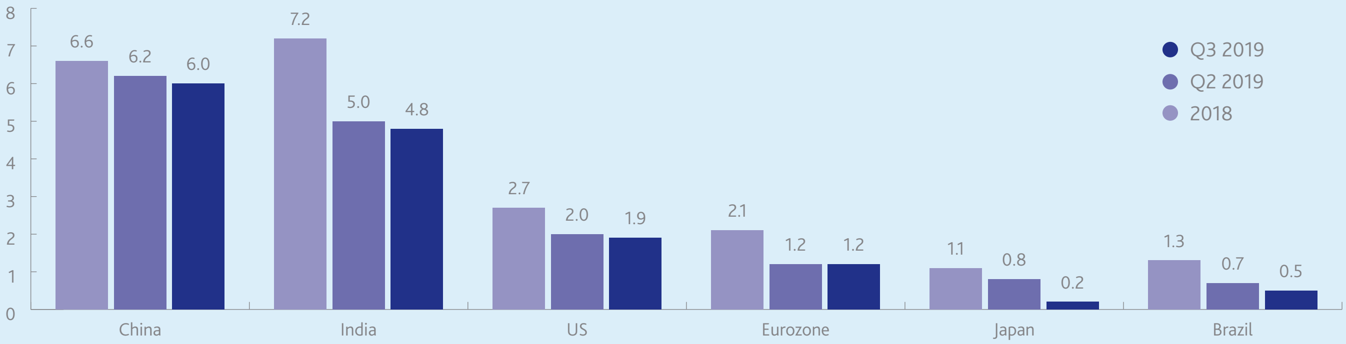
For most of the year, those concerns seemed well justified. Global manufacturing slid from a peak in early 2018 into a severe contraction in 2019. Of concern was the fact that it was not just the US and China, the two main protagonists in the trade war that were affected. Germany, Japan, South Korea and other major export and manufacturing powers all suffered significantly as global trade flows contracted due to increased tariffs. The European auto sector was particularly hard hit as weak demand was exacerbated by the effects of tariffs.

Tariffs did not simply raise the cost of goods, they also helped rewire the direction and magnitude of trade flows. This could clearly be seen across commodity markets, as flows of crude oil, LNG and metal concentrates out of the US and refined products out of China were affected either directly or indirectly. US crude oil, of which Trafigura is the largest exporter, is a clear example, in that volumes that under non-trade war conditions would naturally have flowed to China were instead exported to Europe as China took major supplies of European crude oil.

Gdp growth 2018 vs. 2019

Global

Stated in percent change year-on-year



Chinese growth decelerated markedly this year due to a combination of trade war-related pressures and limits on the debt-led growth that had characterised recent years. Chinese manufacturing contracted for most of the year and industrial profitability slumped. But instead of responding with a big credit jolt as they would have done in years past, the Chinese authorities focused more on the quality of growth rather than the quantity. As such, the emphasis was more on boosting retail spending, services and the value-added transformation of raw materials and components into higher-value end products. This shift in turn meant a conspicuous absence of large-scale infrastructure and real estate projects, which weighed on commodity demand, particularly for key base metals. As a result, growth slumped to the lowest level in almost 30 years, restraining commodity prices even in the face of major supply disruptions across oil and metals markets.

Other markets were not immune, with growth in India also dropping to the lowest level seen in many years, as domestic spending and investment dropped despite lower interest rates and imported crude oil prices. Brazil, which had been recovering in recent years, saw growth recede again on the back of weak investment and spending.

The US, the world's largest economy, continued to march on with its record expansion. Although growth has slowed markedly, it remains positive, driven by strong consumption and retail spending, even as corporate capital expenditure and exports slumped. Record low unemployment, continuing wage growth and ever-higher equity markets all combined to keep consumer confidence high and therefore spending to continue flowing. Whether this persists against the backdrop of a continuing trade war and no retracement on tariffs remains to be seen, but for now the US consumer has helped keep the world from an outright recession.

The weakness in global economic growth was reflected clearly in commodity markets. Despite an unprecedented attack on the global oil market's most critical piece of infrastructure, the Abqaiq processing plant in Saudi Arabia, which had been preceded by major attacks on oil shipping in the Straits of Hormuz, oil remained firmly mired in a band between USD55-60 per barrel (Brent) for most of the second half of the year.

It was a similar story on the metals side, where strikes and unrest in Chile and cutbacks in zinc production failed to materially move metals prices higher. Copper prices fell almost USD1,000 per metric tonne, from their April high of USD6,556 per metric tonne to a low of USD5,600 in September, while zinc lost USD700 per metric tonne from USD2,933 to USD2,205 per metric tonne inside of four months. Aluminium peaked early in our fiscal year, going above USD2,200 per metric tonne in October 2018, only to steadily slide downwards all year to its now rangebound level of USD1,700-1,800 per metric tonne. Nickel was the outstanding performer, rising from a low of USD10,690 per metric tonne at the start of 2019 to a peak of USD18,000 per metric tonne. However, this too was driven by supply issues rather than demand growth, as Indonesia implemented an export ban that limited the quantity of material available.

As we exit our fiscal year, we have seen some early signs of stabilisation in the macro environment, and if there is a positive outcome to the US/China trade discussions then perhaps those green shoots will turn into a more substantial recovery for 2020. If that indeed is the case, then it should be a positive growth environment for commodity demand and trade.

Passenger vehicle sales

Major markets

Stated in million units