Global growth will remain sluggish this year as protectionist tariffs continue to rattle manufacturers, businesses, and financial markets. The U.S. economy is decelerating modestly, and recent economic indicators are sending mixed signals about the outlook. While manufacturing activity tumbled to a more than 10-year low in September, the labor market held steady. We believe that the likelihood of a recession remains relatively low in the near term.

Elsewhere in the world, China’s growth is stabilizing. Recent measures by Chinese authorities, including reducing the amount of money commercial banks must hold in reserves, may have supported economic expansion. The partial trade deal between the United States and China will help lower tensions, but it is unlikely to resolve all the key issues behind the conflict. In Europe, the outlook is cloudier as Germany teeters on the brink of recession and Brexit drags on. Britain’s economy will be the hardest hit by a “no-deal” Brexit. Against this global backdrop, oil prices declined.
Green shoots or false signals?

Global growth is likely to remain sluggish as the trade rift takes a toll on exports, manufacturing and investments.

Consensus growth expectations continue to drift lower. The Organization for Economic Cooperation and Development, the World Bank, the International Monetary Fund, and the World Trade Organization (WTO) have all cut their global growth forecasts. In October, the WTO said global trade volume is expected to rise 1.2% in 2019 — markedly slower than the 2.6% forecast in April. For 2020, the WTO estimates 2.7% trade growth instead of 3.0%. The forecasts from these international institutions are interesting because they reflect an informed consensus.

**Fleeting upturn in China and emerging economies**

There are some green shoots of recovery in the Purchasing Managers’ Index (PMIs) for emerging markets. PMIs typically measure the prevailing direction of economic trends in the manufacturing and service sectors. However, this may well prove to be fleeting. While data shows that a few large emerging-market economies, especially Brazil and Turkey, are picking up, this is only because they are bouncing back from serious downturns. More broadly, there is a seasonal component at work as orders and trade gear up for the Christmas shopping season.

China does seem to be stabilizing. But growth in China will not bail out the rest of the world. The widely followed Li Keqiang (LKQ) index looks a bit better. Chinese imports, however, continue to drop. Things look worse and worse in Hong Kong, but this will not derail the outlook for mainland China. Overall, we believe the policy measures taken by Beijing are bearing some fruit.

Our **Global Nowcast** looks just a little bit better. If you squint, you can see that the Nowcast has ticked up, although it is still very close to the bottom of the post-recession range. Overall, we are pretty much where we were a month ago. It is hard to build a strong case for stabilization at the current growth rate. It is also hard to build a strong case that a recession is just around the corner. The central scenario is for global growth to muddle through.

If you squint, you can see that the Nowcast has ticked up, although it is still very close to the bottom of the post-recession range.
Japan’s sales tax takes effect

The government raised the value-added-tax (VAT) in October to 10% from 8%. Consumer spending has only now gradually recovered from the previous tax increase in April 2014, when the sales tax rose to 8% from 5%.

The 2014 sales-tax hike dented the economy. The country’s GDP contracted at an annualized 7.3% rate in the quarter after an average growth rate of 2.6% during the preceding four quarters as households adjusted their spending habits following the hike. Japan, the world’s third-largest economy, has postponed additional increases since 2015.

Japan is clearly feeling the effects of the weakness in global trade. Consumer spending has kept the economy doing a bit better than expected. The Bank of Japan (BoJ) is waiting to see how domestic spending will react to the latest tax increase. We think the prevailing view is that the impact will be smaller than in 2014. The BoJ’s quarterly Tankan business survey for September showed sentiment among large Japanese companies has improved. But the survey also showed that big manufacturers and non-manufacturers lowered their business investment plans for the current fiscal year. We believe that suggests no major change in the trajectory of the economy.

Europe’s Brexit dilemma

In Europe, we continue to have a gap between the performance of export (and auto) intensive manufacturing, especially in Germany, and the performance of domestically oriented service sectors. Manufacturing has continued to decline. While there are now signs of a spillover into the services sectors, the effects are smaller than one might have expected. In France, for example, domestic consumption indicators still look quite good.

The region would of course be adversely affected by a “no-deal” Brexit, and it could well be enough to tip the eurozone into a recession. Clearly, there have been days when a “no-deal” has seemed quite likely. If this happened, the United Kingdom would suffer the most. While British Prime Minister Boris Johnson displays an irritating combination of ignorance, graceless bravado, and determination on being economical with the truth, we doubt he is prepared to pull the trigger on Brexit. In mid-October, Britain and the European Union agreed to “intensify” Brexit talks. Either there will be a deal by late October or there will be an extension to the deadline and an election.
Within the United States, the messages have been mixed, at least in terms of the headline data. U.S. manufacturing activity tumbled to a more than 10-year low in September and set various alarm bells ringing. The Institute for Supply Management’s (ISM) closely watched manufacturing index dropped to 47.8. It was the second successive reading below 50, a level which indicates contraction in the manufacturing sector. Financial markets fell on the news.

However, a separate survey of manufacturing from IHS Markit showed factory activity increased in September. This tells us something. The ISM manufacturing index is made up of disproportionately large companies, which are feeling the impact of the trade war on their global operations. The Markit PMI survey covers more small and medium-sized companies that are focused on domestic industries. The ISM index just told us what we already knew — that globally integrated manufacturing is suffering under the impact of President Trump’s trade war.

U.S. manufacturing wavers

Manufacturing activity contracted for the second consecutive month in September as tariffs hurt exports, and recession worries have resurfaced.

As we have said in the past, uncertainty over what will come next — uncertainty that Trump seems to view as a negotiating strength — will weigh on the economy. The weakness in the manufacturing sector will affect investment.

Hiring stays steady

The labor market report didn’t really change much at all. Employers added 136,000 jobs in September, and the jobless rate fell to 3.5%. Our preferred index — which aggregates people employed, hours worked, and wages — shows a gradual easing trend. The details in various sectors of the economy vary quite a lot. What is happening in “trade” and “construction” is quite different from what is happening in “leisure” and “health.” Overall, even though the aggregate quit rate rose, the Atlanta Federal Reserve’s wage tracker looks broadly stable. If you look at the number of job openings, or the number of people with more than one job, you come away with a late cycle feel. But the key message is one of gentle weakening.

The main question for the outlook is whether the trade difficulties in the globally integrated sectors of the economy will worsen and generate more problems in the wider economy. In September, the ISM non-manufacturing index produced a negative surprise — it was the weakest reading since 2016. However, the index held above 50 and again sent a somewhat different message than the IHS Markit services index. We need to keep an eye on the underlying story and look at the whole rather than just at one or two data points.
No recession in the cards

So, our assessment of the U.S. economy is unchanged. The economy is decelerating modestly, with strength in housing helping to offset, in part, the weakness from the global trade war and the passing of the fiscal stimulus. The United States is not heading unavoidably into a recession. Something more needs to happen to generate recessionary pressures. That includes a worsening of the trade war, a policy mistake by the Trump Administration or the Federal Reserve, and a significant slowdown in the labor market. The fragilities and risks are obvious, but recession is not our central scenario.

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A divided Fed

All of this brings us back to the Fed. The central bank in September cut its main interest rate — for a second time this year — by another 25 basis points to a range of 1.75% to 2.00%. But the Fed’s statement and the dot plot were a little more hawkish than markets had expected or hoped for. The policy-setting Federal Open Market Committee (FOMC) was deeply divided as well. The dot plot — a visual representation of where policymakers think rates will be over the short, intermediate, and long term — suggests a division between a large minority who expect to cut rates further in 2019 and a small majority who do not.

Fed chair Jerome Powell has downplayed the division at the FOMC and stressed data dependence. Recent comments from FOMC officials suggest there is a possibility the Fed will lower rates further this year. The strength in the housing market will empower those who think the central bank should pause, and the labor market report won’t do more than confirm pre-existing views. On the other hand, only one or two of the centrists on the FOMC need to flip; the ISM manufacturing data may be the catalyst.
In Europe, there are signs of fiscal policy changes to support growth, but in the United States, President Trump’s policies continue to create divisions.

In the eurozone, there has been just a little movement on the fiscal policy front. But let’s not get carried away. Some fiscal relaxation is likely in the future, and this, in turn, will help the region’s economies. Olli Rehn, the Finnish central bank head on the European Central Bank’s governing council, has called on governments to help deliver a better balance of economic policy, noting that “it is evident that the role of fiscal policy is stronger when the effective lower bound is binding.” Some fiscal policymakers have taken note of this.

This is clearest in the Netherlands, where the government announced a fiscal loosening of about 1% of GDP for 2020. This breaks the national fiscal rule. However, because of the Dutch government’s strong overall fiscal position, it is compatible with the European Union’s Stability and Growth Pact. The government also announced a multi-year investment fund that will spend on projects designed to raise long-term growth. Obviously, given the size of the Dutch economy in the eurozone context, this 1% of national GDP doesn’t amount to much, but it is an important political signal.

Greens in Germany lead the way
In Germany, politics are going through a transformation but at a slower pace. In late September, Chancellor Angela Merkel’s government unveiled a $60-billion package of climate policies. The “green investment” plan may well boost the flagging economy over the long term. The measures, however, will be financed without changing Germany’s overall fiscal position. During the debates leading up to this set of investments, two things became clear. The first is that the finance ministry is beginning to relax a little and, if the economic outlook continues to deteriorate, some kind of fiscal stimulus will take place.

The second is that, unlike other European countries where the main threat to the centrist parties comes from the populists of the right and the left, in Germany the main threat is coming from the Greens party. At the margin, the Greens are much less attached to the idea of strict fiscal discipline than the mainstream parties. So, over time, we are likely to see some relaxation in the German approach to public finances.

Trump’s tweets and trade
The trade war continues, and market concerns about it continue to wax and wane. In addition to the U.S.–China trade conflict, there has been a long running dispute at the WTO involving Airbus and Boeing and the extent to which their commercial airliner operations are
subsidized. This case started more than a decade ago, and the United States won the right to impose tariffs on as much as $8 billion worth of EU goods; the EU has said it is considering the use of a different WTO ruling to retaliate with tariffs on $4 billion of U.S. goods.

The threat of tariffs on imports of European vehicles remains, although it seems unlikely tariffs will be imposed in the near future. Again, this illustrates a key feature of the Administration’s trade war and the uncertainty it is imposing on the business sector.

Beyond this, the trade war story continues as it has. The channels of communication between Beijing and Washington seem to be more open than they have been. In early October, the United States and China agreed on the outlines of a partial trade accord that President Donald Trump said he and his counterpart Xi Jinping could sign as soon as next month. Still on any given day, a tweet — or news of a Chinese delegation cancelling a visit to Montana — can move markets.

A short-term deal would lower tensions for a little while, but the key issues behind the conflict are not going to be resolved. China will not give much ground on the key issues of the structure of its economy and the role of its high-tech sector. Trump has every reason to find reasons to keep the issue on the boil. These incentives will only increase as the 2020 elections approach.

Unconventional policy approaches aimed at China

The latest twists in the policy debate link together other strands of thinking. One of the proposals on Capitol Hill included imposing a “market access charge” on foreign purchases of U.S. securities. The White House was also discussing other measures aimed at China, including limiting the ability of the $50 billion Federal Employees Retirement System to invest in the MSCI All Country World ex-U.S. Index.

The underlying story is two-fold. First, the toothpaste is out of the tube now. The Trump Administration has allowed space for unconventional approaches to policy, and as a result, a lot of ideas are being floated. Many of them are bad, and most of them probably won’t get anywhere.

But it’s hard to rule anything out. If the impeachment process does boost the left wing of the Democratic Party, we’ll have to deal with unconventional ideas from both ends of the political spectrum. The centrist politicians who supported the policy consensus of the post-Reagan years are disappearing along with the policies they supported and the economic growth they made possible. Moreover, it is true that the emergency economic powers of the President are extraordinarily far-reaching.

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Second, the trade conflict with China found an unusually broad coalition. The fact that China has not yet offered Trump the kind of deal he wants suggests a new phase is quite likely. Trump has emboldened all sorts of people who are unhappy with China for one reason or another. There are the “trade deficits matter” people and the “national security” folks. There are the “intellectual property” folks, and there are the “workers suffering job/wage losses” folks. Key leading figures in the Democratic Party are protectionist and hostile to China. So, it’s likely that the relationship with China will be difficult no matter who wins next year’s election.
The Putnam Global Risk Appetite (RA) Index is a proprietary quantitative model that aims to measure investors’ willingness to invest in risky assets, including equities, commodities, high-yield bonds, and other spread sectors. With a composite view of risk-appetite signals across a broad mix of asset types, Putnam’s RA Index provides a framework for discussing investor preferences and can signal trend changes in broad market sentiment.

Risk appetite recovered slightly

**SHORT-TERM TREND**
A high degree of dispersion across asset classes as markets look for direction.

- Global equities rose across the board; international markets outperformed.
- U.S. Treasuries declined as the yield curve steepened.
- Government bonds, emerging-market debt, and other fixed-income assets outperformed Treasuries.
- Gold prices slipped amid rising bond yields.

**LONG-TERM CYCLE**
This 10-year illustration captures the cyclicality of investors’ appetite for risk.

Source: Putnam. Data as of September 30, 2019. To create the Global Risk Appetite Index, we weigh the monthly excess returns of 30 different asset classes over 3-month T-bills relative to the trailing 2-year volatility of each asset class. The higher the excess return and the lower the volatility, the greater the risk appetite; conversely, the lower the excess return and the higher the volatility, the stronger the risk aversion.
Global growth shows signs of stabilizing

**SHORT-TERM TREND**

The Nowcast ticked up, but it is still near the bottom of the post-recession range.

Among G-10 economies, the United Kingdom and Canada improved while the eurozone had a disappointing month. In Britain, manufacturing, services, and labor market indicators gained. However, manufacturing PMI in the eurozone faltered. Economic indicators improved in Turkey and Brazil. In China, two gauges for manufacturing activity showed expansion.

▲ 2.10%

**LONG-TERM CYCLE**

This six-year illustration captures GDP gyrations since the financial crisis.

Source: Putnam. Data as of September 30, 2019. We base our Global GDP Nowcast on a tailored methodology that captures daily data releases for the most essential growth characteristics for each of 25 countries — including purchasing managers’ index data, industrial production, retail sales data, labor market metrics, real estate price indexes, sentiment indicators, and numerous other factors. The mix of factors used for each market may change over time as new indicators become available from data sources or if certain factors become more, or less, predictive of economic growth.
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