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# GLOBAL MARKET COMMENT: A TRAIN WITHOUT A LOCOMOTIVE

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**A Train Without a Locomotive**

As the stream of disappointing global economic news continues to trickle in, investors are growing increasingly concerned about the absence of a locomotive to pull the world out of its sharp synchronous slowdown. World GDP growth has sharply decelerated from 4.6% in 2000 to a forecast of 2.6% for 2001, the United States from 5.8% to 1.7%, Germany from 2.3% to 1.3%, and the United Kingdom from 3.9% to 2.1% (see Table A). In recent months, other countries—France, Italy, Russia, Canada, Brazil, and China—have decelerated dramatically, while Australia, South Korea, Mexico, Singapore, Taiwan, and Argentina are on the verge of recession.

Economists have been rapidly ratcheting down their growth forecasts to keep pace with the latest onslaught of negative news. For example, as recently as October 2000, Morgan Stanley Dean Witter had expected world GDP to grow 4.2% in 2001; that forecast is now 2.4%. Over the same period, consensus forecasts for U.S. growth have fallen from 3.7% to 1.8%, while for Europe they are now 2.3%, down from 3.2%. In addition, most developing economies, which remain highly dependent on global trade, are smarting under the effects of the global trade recession. Global trade growth is expected to slow to 4.3% in 2001, down from 12.8% in 2000, representing its sharpest year-over-year deceleration on record.

**Beyond the Valley or Into the Ravine?**

Some analysts argue that now is exactly the time when investors should look beyond the valley and into the future, as opposed to dwelling on the past. In fact, some now see the classic ingredients of a recovery: rapidly growing money supply, resilient housing market, lower interest rates, and a steepening yield curve. In the United States, MZM has expanded by 16% over the last year and at a 20% annual rate over the past three months. The yield curve is steepening, which suggests that the fixed-income market is confident that the worst is over. The spread between the 10-year Treasury note and the 2-year bill has risen 164 basis points (bps) over the last five quarters (from -47 on March 31, 2000 to 117 on June 30, 2001) (see Table B). The corporate yield curve also has steepened, possibly presaging a pickup in sales, and it is now at its steepest since July 1994. In May, the spread between long-term industrial bond yields and three-month non-financial commercial paper stood at 356 bps, after bottoming at an 11-year low of 116 bps in December 2000. In the United Kingdom, the 10-year government bond yield/3-month Treasury bill spread has widened to 122 bps (from -90 on December 31, 2000 to 32 on June 30, 2001), while in Germany, the 10-year government bond/Euro-mark 3-month spread has increased to 55 bps.

Global equity markets still reflect some muted optimism. Global equity analysts have slashed their earnings estimates, such that consensus estimates for the much-hyped technology sector are for earnings to *fall* 33% in 2001 relative to 2000, but *grow* 33% in 2002. That is, analysts expect tech earnings to finish

2002 11% below its actual earnings in 2000, which was quite a bad year for the sector. Analysts also expect global earnings to turn around in 2002, gaining 14% over 2001's depressed results. While these expectations are much more sane than the lofty expectations of yesterday, a turnaround six months from now is by no means guaranteed.

The European Central Bank (ECB) and Bank of Japan are either unwilling or unable to stimulate their economies. In addition, the Bank of England held rates unchanged in June and has shown no inclination to stimulate the economy in the short term. In the United Kingdom, M4 growth decelerated to 2.5% during the first five months of the year, compared to 3.7% for the preceding five months. In Europe, M3 growth decelerated to 2.5% for the six months ended March 31, compared to 3.7% for the previous six months. In early July, the ECB shrugged off signs of the spreading slowdown by refusing to lower interest rates. In fact, bank officials cited inflation concerns (consumer prices rose at an annual rate of 3.4% in June, the largest increase since the euro was adopted in January 1999) when it declared that it would not loosen monetary policy in the near future. Prospects for Japan remain bleak, with the broad measure of liquidity increasing 2.6% on a year-over-year basis, which seems insufficient to bring about meaningful reflation.

**Realistic or Optimistic?**

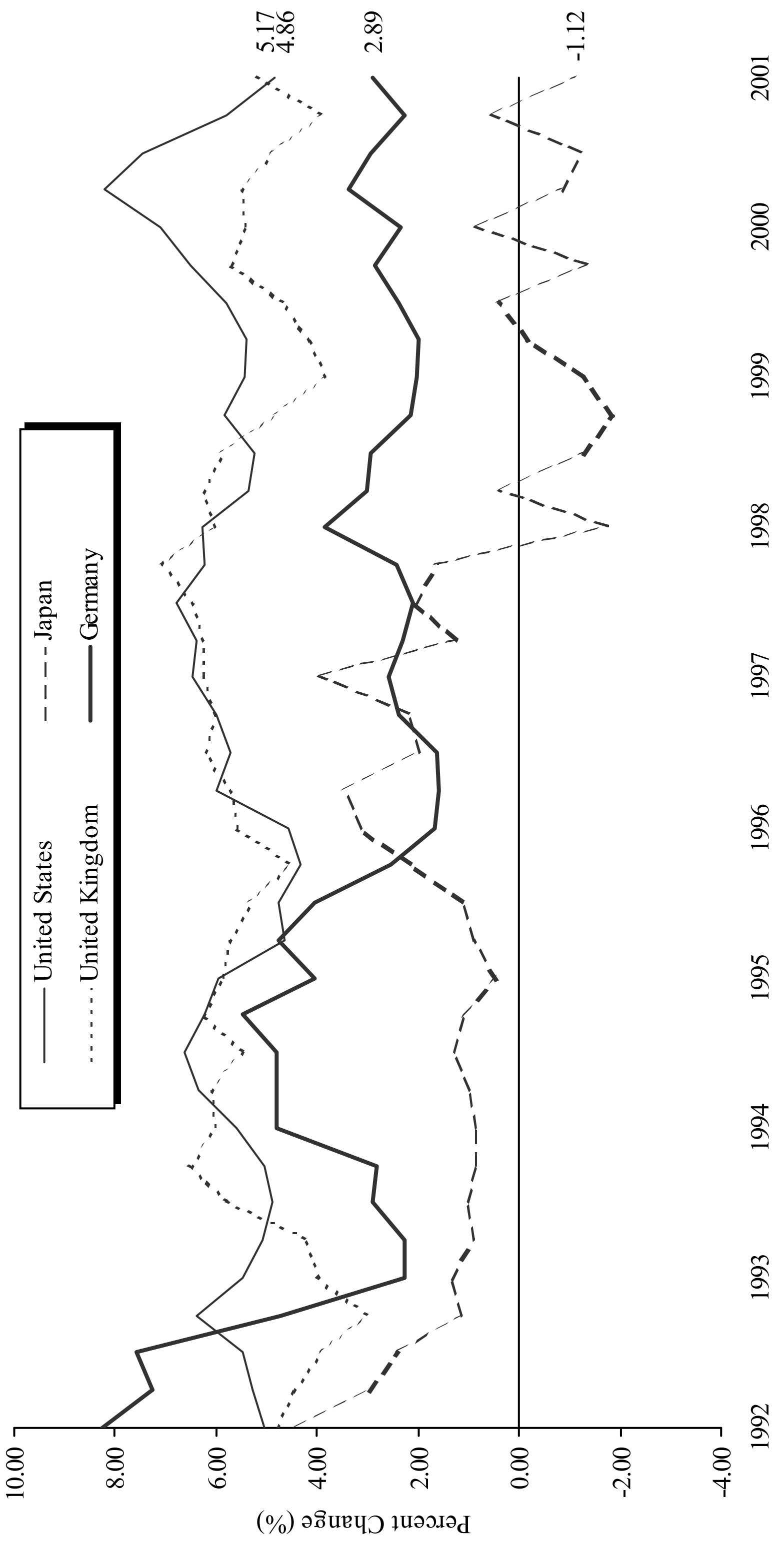
Major central banks are preoccupied with their region's unique economic woes and refuse to initiate a coordinated effort to reflate the global economy. As a consequence, Europe, Japan, and the developing countries will be unlikely to kick start the world economy. The responsibility then presumably falls on the United States, yet it seems ill-equipped to do the world's heavy-lifting at this time, despite the few signs that its economic cycle is in the process of turning. American corporations are currently concentrating on repairing their balance sheets, slashing costs, and cutting jobs—certainly needed activities, but these efforts can increase or stabilize profits only over the short-term. Over the longer-term, corporations need to expand their profits by increasing sales, instead of cutting costs, which requires an improved global macro environment. This, in turn, requires a locomotive to pull the global economy out of its slowdown, but most of those with their ears to the tracks still discern no such train.

## Table A

## GROSS DOMESTIC PRODUCT GROWTH IN LOCAL CURRENCY

**March 31, 1991 - March 31, 2001**

**Year Over Year Percent Change (%)**




Source: Datastream International.

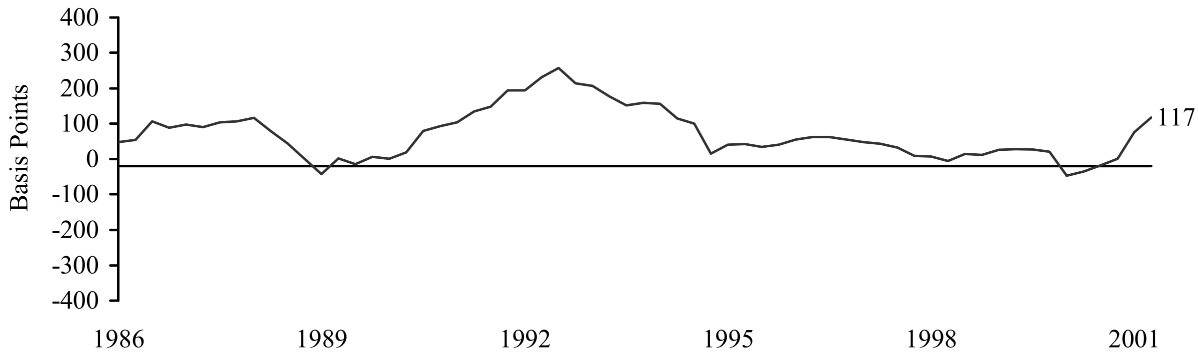
Note: Graph based on quarterly data.

## Table B

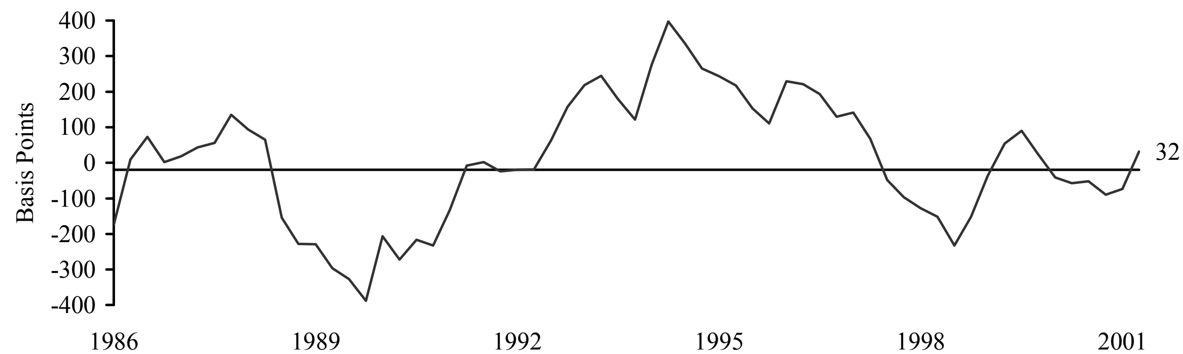
## TREASURY YIELD SPREADS

### March 31, 1986 - June 30, 2001

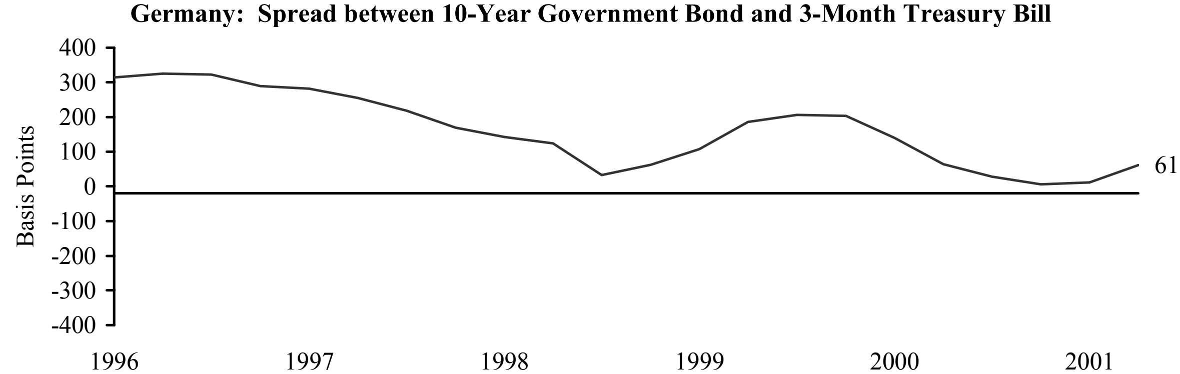
**United States: Spread between 10-Year Treasury Bond and 2-Year Treasury Note**




**United Kingdom: Spread between 7-10-Year Government Bond and 3-Month Treasury Bill**




**Germany: Spread between 10-Year Government Bond and 3-Month Treasury Bill**




Source: Datastream International.

Note: Data for Germany are from March 31, 1996 through June 30, 2001.