Growth and volatility will define global economy in 2016

According to global asset manager PineBridge Investments, the global economy is likely to experience incremental improvement and a consumer-driven "growth bounce" in 2016. This is despite market stress and volatility as a result of diverging monetary policy among central banks and the "dark side of QE" holding back intrinsic recovery forces.

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PineBridge predicts that commodities prices will move higher in the coming year, while the dollar will continue to gain ground against most developed world currencies and US GDP growth will reach 2.7%. In PineBridge Investments' 2016 Outlook, chief economist Markus Schomer explains that extraordinary monetary policy measures have failed to stimulate economic growth and inflation, and are now a growing risk to a sustained recovery following a year of setbacks for the global economy in 2015.

"While the Federal Reserve has started to gradually reduce the emergency monetary policy stimulus, others, especially the European Central Bank (ECB), are still adding to it. Hence, the "dark side of QE" that is holding back the intrinsic recovery forces will continue to dominate the global business cycle in 2016 and beyond, preventing the re-synchronisation of business cycles and maintaining the high level of macroeconomic volatility around the world," Schomer said.

PineBridge's multi-asset team provides their top investment picks for 2016, including equities in Japan, Europe, Mexico and India, as well as US value styles and small cap stocks, and lower quality fixed income investments after a year where credit spreads blew out. Other favourites for this year include US high yield, European US-dollar-denominated contingent convertible bonds, liquid alternatives, bank loans and private credit.

Divergence

Michael Kelly, PineBridge's global head of multi-asset, cited divergence in the global economy as a key factor, noting that it will stimulate growth in the coming year.

"As we prepare for 2016, a massive divergence in the markets must be resolved. Around the globe, basic industry appears to be in recession while the consumer appears healthy and is gathering steam in major economies like the US and China. Markets seem to have priced in that this divergence will continue. We do not think it can - either the consumer will pull industry up, or industry will pull the consumer down. We think the consumer will have the edge and, as a result, we are entering 2016 positioned for a global growth bounce," Kelly states.

After a year in which the commodity price crash and the perception of a more serious slowdown in China weighed heavily on emerging market fundamentals, with the negative impact of lower commodity prices on industrial output outweighing the positive effects of consumer spending, PineBridge expects the global economy to acclimate to these price levels.

While PineBridge believes that it won't be an easy year for investing in equities due to elevated valuations in stable and visible growth stocks and a lack of discernible catalysts to drive corporate earnings expectations higher, there is some good news.

Anik Sen, PineBridge's global head of equities states that, "We believe 2016 will bring opportunities in long-run themes that play across several industries. In the equity markets, these include automation, media, non-residential construction, the Internet of Things, and China's "new" economy."

Monetary policy

The Outlook notes that it is becoming increasingly clear that we are not moving toward less monetary policy domination. But rather than stimulating economic growth and inflation, the extraordinary easing measures of the major central banks are now a growing risk to sustaining the global recovery.

Michael Kelly states, "As we had expected, markets began 2015 exhibiting a trend of low nominal returns with rising volatility. This was a consequence of, and occurred in tandem with, the end of extraordinary monetary accommodation. But then the European Central Bank (ECB) extended the accommodation era by launching its own quantitative easing (QE) programme, only to be joined by most other central banks (with the notable exceptions of the Federal Reserve and Bank of England) cutting policy rates."

Steven Oh, global head of credit and fixed income at PineBridge, adds that, "Quantitative easing is pushing all central banks downstream toward zero rates while the US Federal Reserve struggles to move upstream toward higher ground. The US economy has not yet achieved the underlying economic strength the Fed needs to fight against the effects of global QE."

Fixed income

According to Steven Oh, the path toward US interest rate normalisation will not be easy nor smooth. He believes, "At best, it will be a long and slow process where we see a gradual flattening of the yield curve but ongoing low global interest rates. This will support fixed income assets but result in very low return outcomes for a prolonged period."

Oh adds, "In a connected global capital market, it's difficult to see an outcome where US Treasuries can break away from other "risk-free" sovereign bonds. And the Fed's ability to increase short term rates will be constrained by the potential impact on the currency markets that may filter into the real economy."

Currency

The result of these diverging policies was a wave of competitive devaluations that have greatly increased volatility in currency markets, but have failed to stimulate economic growth. PineBridge expects currency markets to remain volatile in 2016. "The US dollar is likely to gain more ground against most developed world currencies as a result of the expected divergence in monetary policy," Schomer notes. "Outside some selected emerging market currencies, it will be hard to bet against the US dollar in 2016."

Commodities

PineBridge is not expecting a significant rebound in commodities prices but, on balance, there should be a little more demand in 2016 and a little less supply, which should gradually push prices higher again.

Kelly states, "While declining commodities prices have weighed on many emerging economies, price stabilisation in 2016 is likely to be a double-edged sword, driven by supply cutbacks that will put downward employment pressure on commodity-producing economies. Only India and Mexico appear poised to shake off the emerging doldrums."

PineBridge expects the continued rise of the consumer in countries such as China, India, and other emerging markets will be another big theme for 2016 and beyond.

Emerging markets

As a whole, emerging markets have been a big disappointment in 2015. Aggregate GDP growth fell below 4%, which typically corresponds with financial crises such as the Great Recession in 2008, the emerging market debt crisis in 2001, and the Asian financial market crisis in 1998. Schomer points out that, "The fact that we avoided a more systemic emerging market crisis may be a relief."

"In Asia, we expect growth and policy differentials to prompt further currency weakness vis-à-vis the dollar," Michael Kelly stated. "Currencies in Latin America have suffered the steepest declines and could rebound if growth picks up in the region, adding to the policy tightening that is already underway in countries like Chile and Colombia." He adds, "Eastern European currencies are likely to trade with the euro, but should outperform the common currency due to better growth prospects."

US

PineBridge projects that the US private sector should be able to maintain the 3% growth trend we have seen since 2010. "Consumption may run a bit stronger on the back of faster disposable income growth, with business spending a bit lower on rising funding cost. Yet waning fiscal austerity should diminish one of the major growth headwinds, allowing a modest acceleration in US GDP growth to 2.7% in 2016," Schomer states. Steven Oh also notes that, "Low absolute yields are pushing investors toward the US market, where yields are relatively higher."

Europe

After averaging just 0.4% between 2011 and 2014, Eurozone growth improved to about 1.5% in 2015. PineBridge expects the Eurozone can maintain that trend and forecasts 1.6% growth in 2016. "Cyclical forces will drive growth in Europe in 2016," Schomer stated. "Eurozone unemployment has started to decline, consumer confidence is rising, and businesses are looking more positively into the future. Those cyclical forces are likely to drive growth in Europe for the next few years."

China

China's slowdown is structural and official growth numbers have come down sharply in the past four years, so PineBridge believes that the slowdown came as no surprise to investors and should be fully priced into growth, inflation, and earnings forecasts by now. After just missing the official 7% growth target in 2015, PineBridge expects China should post 6.5% GDP growth in 2016. Markus Schomer notes, "The growing number of alternative indicators measuring economic activity in

China point to a much faster deceleration - one that companies are feeling in revenue and profits figures."

Michael Kelly adds, "Instead of markets soaring into this accelerating deluge of monetary accommodation, China inadvertently took away the punch bowl by imposing much stronger measures to slow its debt growth. This led to a surprisingly abrupt halt - not only in China's growth, but also on the industrial side of the global economy, threatening its minimum speed limit."

Japan

Japan's growth continues to stall. Absent a more forceful policy response, PineBridge does not expect Japan's economy will accelerate from last year's modest 0.6% growth pace, and are forecasting only 0.8% GDP growth in 2016. Japan's growth has been more volatile compared with its peers as the country continues to search for a durable recovery. Over the summer of 2015, the economy suffered its fourth recession since 2009," Schomer states.

Anik Sen adds, "Over the coming year, we expect to focus more on the structural changes occurring in Asia and in Japan, as many of these opportunities are powerful, long-run investment themes."

India

Sound economic policy created a virtuous cycle in India in 2015. Economic reforms designed to stimulate competition helped slow inflation last year, which allowed the central bank to cut policy rates.

India's growth trend is expected to accelerate further in the coming years and PineBridge is forecasting 7.7% GDP growth in 2016. "Easier monetary policy helped boost economic activity, which allows the government to accrue more political capital and implement more reforms. Eventually, the Modi government will run into more deeply entrenched interests and the reform efforts will slow. Yet they will leave India's economy permanently stronger as a result," Schomer said.

Middle East and Africa

Gradually increasing commodity prices in 2016 should reduce the growth headwinds in sub-Saharan Africa, allowing robust domestic demand to push overall growth rates higher. We expect 3.5% GDP growth next year for the economies in the Middle East and Africa.