# Bank of England chief issues warnings on global economy

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Bank of England governor Mark Carney has given short shrift to the idea that the agreement between the US and China at the sidelines of the G20 summit last weekend to resume trade negotiations has lessened the dangers confronting the global economy.

Rather, in a major speech delivered on Tuesday, he warned of a "sea change," defined as a "profound transformation," in the global economy with "worrying" portents.

In 2017 the global economy was experiencing its fastest rate of growth since the global financial crisis of 2008. Moreover, there were indications that the world's central banks were looking to return to a more "normal" monetary policy as they cut back on financial stimulus measures. That has gone by the board.

Carney noted that "in recent months, the expected paths of interest rates in advanced economies have shifted sharply lower, most notably in the US, where an expectation of two further rate hikes over the next three years has flipped to four rate cuts by the end of next year." In the euro area, markets had begun to price in further rate cuts and more asset purchases by the European Central Bank.

The interest rate outlook is having a major impact on bond markets, with yields on long-term government bonds falling markedly as their prices rises. The price of bonds and their yield have an inverse relationship.

Carney pointed out that yields on 10-year US treasury bonds were at their lowest point in two and a half years. Yields on the UK equivalent were at their lowest level since the Brexit referendum in 2016 and German 10-year bond yields were at their lowest level ever. All told there is now $13 trillion worth of investment grade debt trading at negative yields—a record. A negative yield means that a purchaser of such a financial asset would make a loss if they held it to maturity.

At the same time, low interest rates had provided "substantial support for equity markets," which had now reached all-time highs in the US, "despite an economic outlook that is becoming less robust and more uncertain."

"These market developments reflect a sea change driven by growing concerns over the impact of rising trade tensions and policy uncertainty. Certainly the portents are worrying," Carney said.

The rising price of financial assets—government bonds and shares—is a kind of fever chart of the growing problems in the underlying real economy.

"Over the past year," Carney noted, "the global economy has shifted from a robust broad-based expansion to a widespread slowdown, with the proportion of the global economy growing above trend falling from four fifths to one sixth."

Trade tensions have considerably increased with Trump escalating punitive measures against China at the beginning of May. He has also threatened action against Mexico unless it falls into line with US demands to clamp down on the movement of immigrants and refugees. Meanwhile, the threat by the US to impose tariffs on auto imports from Europe remains.

Carney said the latest actions mean that "trade tensions could be far more pervasive, persistent and damaging than previously expected" and that the rationales for further action were broadening.

"Initially motivated by concerns over bilateral trade imbalances, trade measures are now being taken in response to issues ranging from immigration to intellectual property protection to control of the technologies underpinning the Fourth Industrial Revolution. It has even become fashionable for some to speak of a new Cold War."

However, this "new Cold War" takes place under very different conditions than of the 20th century, as the escalation of the trade war comes into ever-sharper conflict with the increasingly integrated character of the global economy.

At the height of the Cold War, Carney pointed out, US-USSR trade was worth $2 billion a year while today "US-China trade clocks $2 billion a day."

"More broadly trade in intermediate goods and services has doubled since the fall of the Berlin Wall, and production has become increasingly integrated across borders."

While Carney did not elaborate on this issue, the increasing role of intermediate goods means that the trade conflicts of the present day have a far more explosive content than those of the 1930s. In that period, tariffs were imposed largely on finished goods. Today they are being imposed on goods that form part of a global production system in which the components of any product often cross borders numbers of times before they emerge in finished form.

"Reflecting the more febrile atmosphere, a trade war has shot to the top of the risks most worrying investors and measures of global policy uncertainty have reached record highs," he said.

These concerns are contributing to sharp reductions in corporate earnings expectations with business confidence across the G7 group of countries—the world's largest economies excluding China—falling to its lowest level in five years and "sentiment among manufacturers particularly weak."

The more hostile and uncertain trade environment "is coinciding with sharp slowdowns in global trade, manufacturing, industrial production and capital goods orders," leading to a deterioration in the quality of global growth.

"Across the G7, the growth rate of business investment has almost halved since its peak in late 2017, leaving the global expansion more reliant on consumer spending and reducing its resilience," Carney noted.

However, while corporate earnings expectations are on a downward path, "for the time being," the falls in expected interest rates set by central banks "have cushioned the impact on equity prices."

These comments point to one of the key features of the global economy—the ever-increasing dependence of major corporations on a rise in their share prices resulting from the cuts in interest rates that continually "juice" the markets.

This phenomenon was on display yesterday when Wall Street's Dow Jones index reached an all-time record high, joining the two other major indexes, the Nasdaq and the S&P 500, in hitting record levels.

The rise and rise of the market is completely dependent on the expectation that the US Federal Reserve will cut interest rates, possibly as soon as its next meeting at the end of the month, followed by further rate cuts before the end of the year.

Reporting on the new record, the *Wall Street Journal* cited the comments of Jim Baird, chief investment officer at Plante Moran Financial Advisors. He said if the data on the economy was such that the Fed decided it did not need to move "aggressively" then "investors will likely be disappointed" and "any hint that the Fed may not cut rates will be a catalyst for more volatility."

In other words, any notion of Fed independence has gone out the window. The US central bank operates with the gun at its head to ensure there is no impediment to the accumulation of wealth by parasitic speculation on the financial markets.