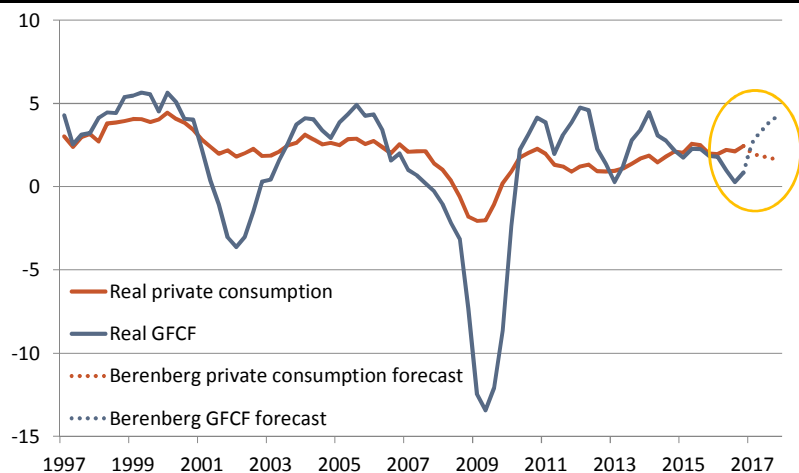


12 May 2017

What is missing from the upswing?

G7: Real private consumption versus real gross fixed capital formation (yoy %)



Quarterly data. Source: OECD, Berenberg calculations. Q1 (except US and France) and Q2 are forecasts taken from Berenberg's *Forecasts at a glance*, 5 May 2017. 2017 data is for G7 ex. Canada.

- **The missing ingredient:** Starting mid-2016, the global economic cycle turned up. After China worries failed to manifest in late 2015 and Europe sailed through Brexit last summer, heightened confidence in the robustness of economic growth encouraged a rise in consumption. Then came along Mr Trump, whose promises of fiscal and regulatory reforms further bolstered markets' expectations of an upswing. However, seven years of sustained moderate growth driven by healthy gains in consumption and housing, but disappointing investment spending, has taken its toll – see chart. Unlike previous upswings where investment growth has accelerated beyond the rise in consumption, this time around firms' expansion plans have been restrained.
- **Still in the age of caution?** Scarred by the excesses that led to the Lehman crisis, firms have been reluctant to pursue aggressive capital spending plans, despite low costs of capital and healthy profits and cash flows. In all advanced nations – the US, Japan, around Europe and the UK – ongoing uncertainties about government policies have added to normal business concerns about sustainable product demand. Recently, some of those fears have dissipated. In the US, President Trump's promise of reform has begun to stir confidence. Outperformance in the UK economy has allayed fears. Growth in Europe has exceeded expectations. Most recently, the election of pro-EU reformer Emmanuel Macron has elevated the push for economic reform in France and in the EU more broadly. The future appears more certain.
- **Fundamentals look healthy:** The ongoing upswing in the developed world is broad-based and synchronised. It would take a major shock to derail it. Meanwhile, high stock market valuations, rising profits and high cash flows from strong demand, and low costs of capital thanks to accommodative monetary policies, provide a solid foundation for capital investment. Now, heightened confidence and diminished uncertainty add to those positives.
- **Turning the corner:** After weak growth last year, key leading indicators for investment, such as firms' expected sales over the next 12 months, have turned up sharply across major parts of the developed world. In the US and France, where Q1 data are already available, business investment has rebounded impressively. This is encouraging. It suits our calls that investment spending is on course to catch-up and complement sustained healthy consumption growth over the course of the year. Over time, this can add even more momentum – and longevity – to the upswing.
- **How long will it last?** US tax reform is critical. If the Trump administration can reform US corporate taxes, by reducing rates and expanding the base, and, critically, enacting the expensing of new investment, capital investment growth will jump. This would boost productivity and sustained potential growth. If Donald Trump and Paul Ryan disappoint, the false dawn would likely trigger firms in the US, and elsewhere, to roll back planned expansions. We expect Trump will deliver, probably in autumn 2017, and contribute to the economic upswing in the developed world. It would be nice to put the age of caution behind us. Time will tell.

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