How's the global economy doing? The hesitant upswing

An imminent upturn in investment spending

Any first-year student of the dismal science learns that investment is the key ingredient to sustainable long-term economic growth. By forgoing consumption today to save and invest, economies accumulate the capital necessary to produce even more stuff for tomorrow. But investment is risky. Those with the means need to feel confident about the future before investing. Not everything that is produced is consumed. Economic agents are careful with their hard-earned savings. Nothing but these shifts in sentiment – the bull and bear animal spirits – drive the ups and downs of the economic cycle.

Resilience breeds confidence. After China worries failed to manifest in late 2015 and Europe sailed through Brexit last summer, heightened trust in the robustness of economic growth encouraged households to open their wallets and spend more freely. Starting mid-2016, global demand growth began to accelerate after years of sluggish growth since the financial crisis. Then came along Mr Trump, whose promises of fiscal and regulatory reforms further bolstered markets' expectations of an upswing.

However, seven years of modest growth driven by healthy gains in consumption and housing, but disappointing investment spending, have taken their toll. Unlike previous upswings, where firms have been quick to commit capital to get in on the action early, investment spending remains subdued.

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 cash flows. In all advanced nations, uncertainties about government policies have added to normal business concerns about sustainable product demand. Recently, some of those fears have dissipated. In the US, 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.

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Finally, the future appears more certain and 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 revenues and profits from strong demand, and low costs of capital thanks to accommodative monetary policies, provide a solid foundation for capital investment. Now, diminished uncertainty and heightened confidence add to those positives.

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. This is encouraging. If investment spending picks up, it will 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 US productivity and potential growth.

While emerging giants like China and India have closed the gap in recent years, the US remains the most systemically important economy in the world. For better and for worse, the US economy has the final say on the pace of global 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.

But if Trump delivers, an acceleration in US economic growth will reinforce 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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