KEY TAKEAWAY

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Concerns About Trade, Higher U.S. Interest Rates Weigh On Equity Prices

International equity prices declined in May on renewed investor fears about higher U.S. interest rates and worsening trade disputes. Though broader global economic trends remain healthy and corporate earnings growth has brightened, there are growing concerns about the negative impact of higher interest rates on countries and companies with large debt burdens. Emerging markets underperformed during the month, as some of the currencies came under pressure. However, several of the large emerging countries including China and India reported strong growth during the first quarter of this year. Economic growth in the Eurozone moderated during the first quarter, compared to last year, but was still above 2% annualized. The Japanese economy was largely unchanged when compared to the last quarter of 2017.

After a strong start during the first quarter, global manufacturing growth appears to be moderating more recently. Manufacturing sector growth turned softer in May when compared to the previous month, though the pace of expansion remains robust. The Eurozone and Japan continued to see slower growth, while most emerging markets also saw more subdued factory activity. The continued expansion in production of investment goods across most regions is a positive sign as it is indicative of a recovery in capital investments by businesses. Employment in the manufacturing sector increased as well, though at a slower pace when compared to April. Global services activity strengthened in May, though the gains were limited by the slower pace of growth in the Eurozone and Japan.

NEAR-TERM OUTLOOK

Global economic growth continues to strengthen and should help allay some of the investor unease that caused the recent market volatility. The International Monetary Fund (IMF) estimates that global growth will be close to 4% this year as well as in 2019. While the developed world is likely to see a slight moderation in growth pace, the emerging economies are expected to accelerate to an annual growth in excess of 5% by next year. Domestic demand remains healthy across most major economies, supported by strengthening labor markets and improving wages. Inflation remains under control and below historical averages for past economic upturns and should give more policy flexibility to central banks. The moderation in growth in the Eurozone and Japan could encourage their central banks to extend their ongoing quantitative easing programs.

However, worsening trade disputes could weaken the ongoing cyclical recovery in global trade and limit aggregate global growth. The standoff that started earlier this year with the U.S. administration's imposition of additional import duties on select metals continues without any signs of an early settlement. Aggressive statements have made the renegotiation of existing treaties such as the

NAFTA more difficult. While it is more likely that these disputes will be eventually sorted out on terms acceptable to all sides, the uncertainties could make markets more volatile in the interim.