EUROPEAN ECONOMIC OUTLOOK

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I have just returned from a series of central banking-focused events in Frankfurt and Madrid, organized by the Global Interdependence Center (GIC).

Last week's "Behind the Markets" podcast highlighted key takeaways from these events, with Stephen Sexauer, Chief Investment Officer of the San Diego County Employees Retirement Association, and José Brito, Chief Economist for Milleniumbcp, a Portuguese bank.

The podcast concluded with Jillian Fornito, Executive Director of the GIC, who highlighted upcoming GIC events.

Sexauer's Outlook on Europe for the Next Decade

Sexauer commented that while most economic discussions are dominated by the role of central banks in solving the world's growth challenges, central banks themselves increasingly deflect the focus with commentary like "there are limits to what we can accomplish." Similarly, they emphasize the need for fiscal coordination and regulatory reform to encourage favorable labor market conditions and productivity gains.

He pointed to the decline in the number of pages in the U.S. Federal Register as one piece of evidence that the domestic business climate is getting easier. There were over 97,000 pages in 2016, and about two-thirds of that (68,000) in 2018.[1]

Sexauer added that Brexit risks are really high for the European economy, and the old rule that all negotiation takes place near or after the deadline seems to be holding steady. However, he also believes there is a good probability Brexit will be resolved more positively than is anticipated in the markets today, signaling an opportunity for European-focused investments.

The last 10-year stretch for European equities has been dreadful, as they have underperformed U.S. equities by over 6 percentage points a year for the last decade. Sexauer would not bet against Europe for the next 10 years. We may not know why, or what the rebound catalyst will be today, but the differentials that we've seen in the post-financial crisis era are unsustainable, in Sexauer's view.

Lessons from the Crisis: Portugal's Case Study

Brito discussed how painful the Portuguese financial crisis was without exchange rate flexibility to devalue the currency, since Portgual is part of the eurozone. Portugal was forced to internally devalue to be more competitive, and eventually emerged from the crisis thanks to its exporting prowess. A lot of Portuguese companies failed during the crisis, but it was a relatively short-lived "depression" given quick adjustments.

Brito highlighted how Portugal has recently been growing faster than its European peers, with investments and exports both growing faster than GDP.

When the European sovereign debt crisis hit, almost all Portuguese banks were insolvent. State funding helped banks stay afloat and foreign shareholders chipped in. A Chinese conglomerate acquired Millenium bcp's assets at distressed prices, while also buying insurance and health care operations as well. It is an interesting example of how Chinese firms capitalized on fire-sale prices to establish a platform in Europe.

Given all dynamics in the economy and the technical patterns, Brito sees the euro hitting parity with the dollar before climbing back to €1.20.

Upcoming GIC Events

Fornito discussed some of the upcoming GIC events in Philadelphia in December, and in San Diego in February 2020.

This was a great discussion on the current state of world economic growth, returns and the potential for Europe to turn the corner. Please listen to the full conversation below.

[1]Source: https://www.llsdc.org/assets/sourcebook/fed-reg-pages.pdf

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DEFINITIONS

Brexit : an abbreviation of "British exit" that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.