



Globalization Meltdown

WINTER 2016



De-globalization trends are rife. As governments retrench to focus more domestically and political change continues unabated, **Sinead Colton, head of investment strategy at Mellon Capital,** discusses key milestones for the year ahead and what they might mean for global markets and investor expectations.

In 2016, for the first time in 15 years, the World Trade Organization (WTO) forecast global trade growth, at just 1.7%, would not keep pace with global GDP growth. Over the longer term, world trade has usually grown 1.5 times as rapidly as total economic output, said the international agency.¹

Roberto Azevêdo, the WTO's director-general, warned "this dramatic slowing of trade growth is serious and should serve as a wake-up call," adding that it is particularly concerning "in the context of growing anti-globalization sentiment."

GROWING ANGER

Sinead Colton, head of investment strategy at Mellon Capital, says it is important to recognize what is driving this de-globalization. "In many parts of the developed world, we can see anger that there has not been widespread participation in the somewhat lackluster growth since the financial crisis."

"Arguably the impact of quantitative easing has disproportionately benefited asset owners, helping wealth distribution to shift significantly toward the highest earners."

In conjunction with this perceived inequality, austerity policies from many governments have led to cuts in public service funding. Colton says the way citizens respond to such a combination of factors differs across the globe, but that a couple of common enemies are starting to emerge — immigration and trade.

U.S. ELECTION FALLOUT

In the U.S., the manifestation of de-globalization was intrinsically linked to the presidential election. During the campaign trail, both candidates were outspoken against the Trans-Pacific Partnership (TPP), a trade agreement seven years in the making.

Colton says that for many people in the U.S., the North American Free Trade

1. *The Wall Street Journal*: 'World Trade Set for Slowest Yearly Growth Since Global Financial Crisis,' September 27, 2016.

Agreement (NAFTA) is associated with factories closing down and jobs moving overseas, even though many economists argue the pact has had a net positive impact on U.S. GDP. “If, as expected, President Trump pulls out of the TPP, the U.S. will lose its voice in the Asian region from a trade perspective. The next most likely step is the progression of a trade pact led by China — the Regional Comprehensive Economic Partnership (RCEP). This would open up trade between the Association of Southeast Asian Nations (ASEAN) states and the six states with which they have existing free trade agreements (Australia, New Zealand, India, Japan, South Korea and China).”

China and India are excluded from the TPP, so they have been negotiating the RCEP in tandem. If the TPP breaks down because of a U.S. withdrawal, China would be in the driver’s seat, with the RCEP poised to fill the gap, says Colton. After two terms of President Obama attempting to steer the U.S. into a dominant position to shape global trade policy, it appears likely the U.S. will become more protectionist during the next presidential term.

ALL EYES ON THE UK

Following the UK’s 2016 Brexit vote, Colton says the country will be the “one to watch” in 2017. Prime Minister Theresa May aims to trigger Article 50 by the end of March 2017 if she can. While there is no certainty this will happen, when and if it does, the countdown for negotiations will begin. At that point the UK government’s bartering power arguably diminishes as the two-year negotiation timetable counts down, Colton continues.

An extension of this negotiation period could possibly be granted, but this requires unanimous agreement from all 28 EU states — the UK plus the 27 who will remain.

The government seems to be coming down more firmly on the side of limiting the free movement of people and potentially willing to give up the benefits of full EU access as a result, says Colton. Developments will be watched keenly.

ELSEWHERE IN EUROPE

With French and German elections next year, we will also see a great deal of discussion around immigration. “German Chancellor Angela Merkel does not want to appear too soft because she has been losing ground to the right-wing AfD (Alternative for Germany) party in some of the regional elections. In France, President François Hollande will also have to contend with nationalist forces in the right-wing and euroskeptic Front National.”

Leader of Front National Marine Le Pen has gained some impetus following the Brexit vote and terror attacks in France during the summer of 2016 and she has vowed to hold a referendum on EU membership if elected. She is not alone, as anti-establishment parties in the Netherlands, Germany, Italy and Austria have also called for referenda on EU membership.

Says Colton: “Former president Nicolas Sarkozy also threw his hat in the ring for the French presidential election in 2017, with a focus on citizenship and anti-immigration rhetoric, so it will be interesting to hear President Hollande’s

messaging and see where he falls on the protectionist spectrum.”

CHINA'S GROWING INFLUENCE

“Broadly speaking, protectionism does not seem to be on the rise in Asia. Undeniably, China wants to play a more dominant role on the world stage and some of the dynamics being set in motion elsewhere could help them achieve that,” Colton believes.

An increase in tariffs that are not conducive to broader global investment in other regions could enhance China's influence within Asia. She says Japan is somewhat unique in that it has embraced globalization selectively. “To the same extent we see China's influence increasing both within Asia and globally, it is also reasonable to expect Japan's influence will wane.”

DE-GLOBALIZATION TO STAY?

How realistic is it to expect the underlying drivers of discontent to diminish? Colton says that if we start to see stronger global economic growth, where the benefits are distributed more broadly across society, you could see the popularity of anti-establishment parties abate.

“Average wages in the U.S. have not increased significantly during the economic recovery yet but perhaps an increase in the minimum wage could have a positive impact there,” she comments.

The austerity message has already been downplayed across many economies and could result in increased government spending. Colton believes this should help boost growth, with the caveat that it remains to be seen if that can filter its way

through society more successfully than the injection of liquidity through asset purchases did.

“In the U.S., the consumer has been the strongest driver of the economy. For a more sustainable recovery, we need to see economic strength become more broadly based. An increase in investment from companies, rather than the large amounts of share buybacks prevalent in recent years, is also necessary. This has been largely missing from the recovery over the past four to five years.”

However, investment by companies is unlikely where there is domestic uncertainty, so it's reasonable to expect companies in the UK will look to delay capital expenditures until they have greater clarity around Brexit.

“We do not believe protectionism is a way to stimulate global growth. It may provide short-term gains for individual economies but over the long term, I would expect it to be a drag on global growth.

“The IMF estimates world output could be reduced by as much as 2% over the long run if import prices rise by 10% due to the introduction of new tariffs (World Economic Outlook, October 2016).

“Globally accessible markets are very important to most businesses because they mean companies are less reliant on consumers or markets in their domestic area and have much broader prospects. With greater restrictions and, therefore, fewer opportunities, logic dictates that companies in aggregate would be less profitable, which would likely result in lower investment and lower growth overall,” concludes Colton.

What to Watch in 2017

- The newly elected U.S. president pulling out of the TPP.
- UK triggering Article 50.
- Anti-establishment rhetoric in French and German elections.

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