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MARKET SIGHT LINES

Heightened Geopolitical Risk and a Slowing Global Economy Threaten the Soft Landing

By Michael O'Keeffe, *Chief Investment Officer*

As we enter the fourth quarter of 2024, investors will face multiple sources of uncertainty that could put a soft landing at risk. The potential for higher oil prices may fuel higher inflation, while China's economic slowdown and Europe's recessionary pressures may prove troubling for some globally-oriented companies. In this Sight|Lines, we consider the convergence of these global risks and how they may influence the economy and markets for the rest of this year and next.

THE TAKEAWAY: GLOBAL RISKS THREATEN THE SOFT LANDING

While a soft landing appears to be the base case here in the U.S., geopolitical tensions and global economic weakness are increasing U.S. economic and market risk. In summary:

- There's increased risk of the escalation of one or more of the current localized wars: Russia-Ukraine, Israel-Hamas, and Israel-Hezbollah.
- The risk of Iran and other countries being drawn into the Middle East conflict has led to oil prices rising off recent lows, with a chance of higher prices still, creating an inflation risk.
- China's growth in 2024 is likely to be below the government's target of 5%.
- China unveiled its most aggressive stimulus package since the pandemic to bolster the economy, but many question if this support will be enough.
- There's growing economic divergence across Europe, with Germany's economy contracting during the second quarter, increasing the risk of recession in the region.
- China's slowing growth is likely influencing Europe, given their trade relations.
- Given weakness in China and Europe, investors will increase focus on U.S. companies that depend on those regions for their business and revenues.

IN-DEPTH: GLOBAL RISKS LIKE A SLOWING CHINESE ECONOMY, A POSSIBLE EUROPEAN RECESSION, AND HIGHER OIL PRICES THREATEN THE SOFT LANDING

Geopolitical tensions and pockets of global economic weakness are threatening a soft landing. Going deeper:

- There's an increased risk of the escalation of one or more of the current localized wars:
  - Israel and Hezbollah are fighting an aerial campaign with fears it could become a ground offensive.
  - Iran has delivered close-range ballistic missiles to Russia, while Ukraine has reportedly developed its own ballistic missile that may be able to reach Moscow.
- Oil prices have risen off recent lows, and escalation may push prices even higher:
  - Brent Crude oil reached $75.17 per barrel, after reaching a recent low of $69.19 earlier in the month.
  - Higher oil prices may trigger a resurgence of inflation.
- China's growth in 2024 is now at risk of being below the government's target of 5%.
  - Deflationary pressures are evident: The GDP deflator, a measure of economy-wide prices, has fallen for five straight quarters.
  - Investors are worried this may create a spiral as consumers delay purchases because they expect prices to fall further.
  - The property market, a key driver of the economy, saw investment fall 10.1% in the first half of the year compared to a year ago, while property prices continue to decline.
- In turn, China this week unveiled its most aggressive stimulus since the pandemic, which includes:
  - Liquidity measures, essentially lowering rates and bank reserve requirements.
  - Real estate measures, like lowering the borrowing costs on $5.3 trillion in mortgages.
  - Equity market measures, with both borrowing facilities and cash to support stock purchases.
- There's growing economic divergence across Europe:
  - Germany's GDP declined 0.1% in the second quarter, while Spain's expanded 0.8%.
  - The S&P Global Composite Eurozone PMI declined to 48.9 in September, signaling contraction.
  - The S&P Global Manufacturing Eurozone PMI sits 44.8, signaling contraction and possible recession.
- Europe is one of the world's most trade-sensitive economies, so China's troubles may be having an impact:
  - 9% of European Union (EU) exports and 20% of EU imports are with China.
- Weakness in China and Europe will influence the performance of U.S. stocks:
  - Roughly 8% of revenue for S&P 500 companies comes from China.
  - Five of the "Magnificent Seven" stocks generate more than 10% of revenue from China.

CONCLUSION

Investors face multiple sources of global uncertainty that may put the soft landing at risk, including Middle East wars, the risk of higher oil prices and inflation, and economic weakness in China and Europe. We will see an increased focus on how countries and companies navigate these challenges, an important focus for investors.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

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