MORNING BRIEFING
November 8, 2017

Global Warming

See the collection of the individual charts linked below.

(1) Lots of good explanations for secular stagnation. (2) Lots of good explanations for emerging global boom. (3) Looks like Rogoff was right, while Summers was wrong, about secular stagnation. (4) Time does heal lots of wounds. (5) Global M-PMIs strong. (6) German factory orders and Eurozone retail sales at record highs. (7) Forward revenues confirming strong global growth. (8) Global stock markets running with the bulls.

Global Economy I: Rogoff's Thesis. Yesterday, Debbie and I reviewed the indicators suggesting that the US economy might be on the verge of booming after a long period of subpar growth from 2011-2016. The same can be said of the global economy outside the US, and particularly the Eurozone. Lots of good reasons have been proffered for what was widely described as "secular stagnation." We added to the list with our focus on aging demographic trends around the world. Other observers focused on high debt-to-GDP ratios. Everyone was surprised by how little bang per buck/euro/yen the major central banks were getting for their ultra-easy monetary policies.

In any event, there has been a raging debate between economists who've argued that stagnation is secular and those who've believed it would pass. The data are starting to support the latter camp. Before we review the latest global stats, here is a brief profile of the academic leaders of the two camps:

(1) *Larry Summers*, a Harvard professor, first stirred up the big debate on whether the United States is mired in a protracted period of secular stagnation in an off-the-cuff presentation at an IMF forum on November 8, 2013. He followed it up with an op-ed in the 12/15/13 *FT* titled "Why Stagnation May Prove to Be the New Normal." He concluded that "the presumption that normal economic and policy conditions will return at some point cannot be maintained."

He based that mostly on the subpar performance of the US economy during the current economic recovery. He noted that economic growth has been weak despite near-zero interest rates. He also worried about deflationary pressures in wages and prices that could cause consumers to delay spending. Worsening the situation was income inequality, in his opinion. Summers has argued on numerous occasions over the past couple of years that the world has a glut of savings and shortage of investment demand. His solution is a typically Keynesian one: the government should borrow to fund public investment.

(2) *Kenneth Rogoff*, who is also a professor at Harvard, explained that history shows that slow growth is common following severe financial crises. He predicted that secular stagnation would turn out to be a temporary phenomenon.

Rogoff posted an April 22, 2015 article on this subject, fittingly titled "Debt Supercycle, Not Secular Stagnation." He rejected the view that the world is experiencing secular stagnation "with a long future of much lower per capita income growth driven significantly by a chronic deficiency in global demand." Instead, he argued that weak global economic activity since 2008 reflected "the post-financial crisis phase of a debt supercycle where, after deleveraging and borrowing headwinds subside, expected growth trends might prove higher than simple extrapolations of recent performance might suggest."

He concluded that in this situation, debt-financed fiscal spending is counterproductive: "[O]ne has to worry whether higher government debt will perpetuate the political economy of policies that are helping the government finance debt, but making it more difficult for small businesses and the middle class to obtain credit." In his opinion, time heals all wounds: "Unlike secular stagnation, the debt supercycle is not forever. As the economy recovers, the economy will be in position for a new rising phase of the leverage cycle."

Global Economy II: Getting Hotter. The data suggest that Rogoff is turning out to be right after all. Nevertheless, we still see some specific explanations for the global economy's warming trend, other than "time heals all wounds." We've focused on the stimulative impacts of lower oil prices, ongoing monetary easing (on balance) by the major central banks, a record increase in Chinese bank loans, mass migration into Europe, and the wealth effect from soaring stock prices.

Today, let's review the latest batch of global economic indicators:

(1) *Global M-PMIs*. The global M-PMI has been very strong over the past few months, rising to 53.5 during October, led by the M-PMI for the advanced economies, which rose to 55.2 last month (*Fig. 1*). Leading the way higher among the advanced economies has been the Eurozone's M-PMI, which jumped to 58.5 last month (*Fig. 2*). Leading the way in the Eurozone has been Germany's M-PMI, which was red hot at 60.6 during October (*Fig. 3*). Not far behind were Spain (55.8), Italy (57.8), and France (56.1).

By way of comparison, here at home in the US, the M-PMI edged down to a still solid 58.7 during October with impressive readings for its three major subcomponents: new orders (63.4), production (61.0), and employment (59.8) (*Fig. 4*).

(2) *German factory orders.* Confirming the strength in Germany's M-PMI are the country's new factory orders during September (*Fig. 5*). They rose to a record high led by strength in foreign orders, particularly capital goods orders. That's a sure sign of better global economic growth.

(3) *Eurozone retail sales.* The volume of Eurozone retail sales excluding motor vehicles has been on a steepening upward trend since 2013 (*Fig. 6*). It rose to a new record high during October 2016, and has continued to move into record-high territory since then. It jumped 0.7% m/m during September (3.7% y/y) through September. This time, Germany isn't leading the way higher but rather France, with a y/y increase of 4.6% (*Fig. 7*).

(4) *Forward revenues.* Since the S&P 500 companies get almost 50% of their sales from overseas, Debbie and I view S&P 500 forward revenues as a great weekly proxy for global economic activity (*Fig. 8*). It has been on a steep uptrend since early 2016. Consensus revenue estimates for 2018 and 2019 have been edging higher recently. The same can be said of the forward revenues for the All Country World ex-US MSCI stock composite (*Fig. 9*).

Global Stock Markets: On Fire. While President Trump's tweets often imply that he deserves most of the credit for the record highs in US stock price indexes since Election Day, he can't take credit for the global bull market in stocks. Joe and I believe that credit belongs to the strength of the global economy. Joe and I believe that credit belongs to the strength of the global economy. Here is the performance derby through Monday of the major global MSCI stock price indexes (in local currencies) since November 8, 2016: Japan (30.0%), Emerging Markets (24.7), EMU (23.1), United States (21.1), All Country World (21.0), and the United Kingdom (10.2).

Since late last year, we've ventured forth from our Stay Home investment strategy to the Go Global alternative. In local currencies, much of the outperformance of the All Country World ex-US stock price index occurred late last year relative to the US MSCI stock price index (*Fig. 10*). So far this year, the former is up 15.4% through Monday, while the latter is up 15.9% (*Fig. 11*). The EMU MSCI in euros is up 14.1% ytd (*Fig. 12*). On the other hand, the Emerging Markets MSCI stock price index has been on a tear, rising 27.3% and 31.2% ytd in local currencies and in dollars (*Fig. 13*).

CALENDARS

US. Wed: MBA Mortgage Applications. **Thurs:** Jobless Claims 232k, Wholesale Inventories 0.3%, Weekly Consumer Credit Index, EIA Natural Gas Report. (*Wall Street Journal* estimates)

Global. Wed: China Trade Balance $39.5b, China Foreign Direct Investment, Japan Leading & Coincident Indexes 106.6/115.9, Japan Machine Orders 2.0% y/y, BOJ Summary of October Meeting. **Thurs:** Germany Trade Balance (euros) 22.5b, China CPI & PPI 1.7%/6.6% y/y, ECB Publishes Economic Bulletin. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q3 Earnings Season Monitor (*link*): With 85% of S&P 500 companies finished reporting Q3-2017 earnings and revenue results through midday Tuesday, their percentage surprise and y/y growth results are mostly weaker compared to the same point during the Q2 earnings season, but more companies have reported positive y/y revenue and earnings growth. Of the 425 companies in the S&P 500 that have reported, 74% exceeded industry analysts' earnings estimates, by an average of 5.6%; they have averaged a y/y earnings gain of 8.1%. At the same point during the Q2-2017 reporting period, a lower percentage of S&P 500 companies (72%) had beaten consensus earnings estimates by a higher 6.1%, and earnings were up a higher 12.3% y/y. On the revenue side, 67% beat sales estimates so far, with results coming in 1.3% above forecast and 5.7% higher than a year earlier. At this point in the Q2 season, a higher 68% had exceeded revenue forecasts by a lower 1.1%, and sales rose a lower 5.4% y/y. Q3 earnings results are higher for 71% of companies, vs 72% at the same point in Q2, and revenues are higher for 79%, vs 81% a quarter ago. Although these figures will continue to change as more Q3-2017 results are reported in the coming weeks, particularly for the retailers, the results are very encouraging. Q3-2017 will mark the fifth straight quarter of positive y/y earnings growth despite the negative impact of the three hurricanes. Y/Y growth fell back into the single digits during Q3 from double-digit percentage growth in H1-2017, which were the first double-digit growth quarters seen since Q3-2011. However, Q3 growth will probably mark a low point as tax reform should boost growth back into the double digits.

US ECONOMIC INDICATORS

JOLTS (*link*): Job openings edged up 3,000 in September, after falling 50,000 in August, to 6.093 million—holding around July's record high of 6.140 million. Meanwhile, hirings sank for the second month, by a total of 248,000 to 5.273 million, while separation fell 122,000 over the period to 5.240 million. The latest hirings and separations data yielded an employment advance of 33,000 for September, 15,000 above September's payroll gain of 18,000—coming in above payroll employment for the fifth time in eight months. September's job-opening rate (4.3%) was at its record high for the fourth month, while the total hires rate (4.0) edged down for the second month from its cyclical high of 4.2% in July; the quit rate (2.4) held just below May's cyclical high of 2.5% for the fourth month. September's ratio of unemployed workers per job opening (1.12) was back down at January 2001's record low.

GLOBAL ECONOMIC INDICATORS

Eurozone Retail Sales (*link*): Eurozone retail sales climbed again in September, reaching a new record high. Sales jumped 0.7% after a 0.1% downtick in August and no change in July—with revisions virtually wiping away the preliminary 0.8% drop over the two-month period. Spending on food, drinks & tobacco rebounded 1.3% in September after a two-month slide of 0.6%, while non-food products climbed for the fifth month, up 0.5% m/m and 2.2% over the period. Meanwhile, automotive fuel sales dropped for the third month by a total of 2.1%. Data were available for three of the Big Four economies: France (1.2%) posted one of the largest sales gains in the Eurozone, while Germany (0.5) and Spain (0.4) were also in the plus column, with the former recovering from a two-month slide. Ireland (1.4) and Luxembourg (1.3) were the top Eurozone performers, with France rounding out the top three; Slovenia (-0.3) was the only available Eurozone country to record a decline in September.

Germany Industrial Production (*link*): German industrial production hit a speed bump in September, remaining in record territory. Germany's headline production—which includes construction—sank 1.6% after jumping 2.6% in August (the biggest gain in more than six years) to a new record high. (Excluding construction, production fell 1.8% after a 3.0% leap in August.) Manufacturing output slumped 1.5% after a 3.1% surge in August, led by a 2.7% drop in capital goods production; intermediate (-0.8) and consumer (-0.3) goods output levels were fractionally lower. Energy output tumbled 4.3%, following September's 2.4% advance, while construction output edged up 0.4%. After release of the data, the Ministry said that production remained "very lively," adding, "Overall, industrial production should expand further in coming months." Supporting this prediction are the robust 1.0% jump in factory orders in September to a new record high, record-high optimism among German businesses in October, and the Germany's strong M-PMI—which held at a six-and-a-half-year high of 60.6 last month.

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