



MORNING BRIEFING

April 9, 2019

Global Growth Dearth

See the [collection](#) of the individual charts linked below.

(1) Everybody is easing, so why is the global economy so weak? (2) Still expecting a peace dividend once Trump wins his trade wars. (3) The 1990s all over again with a few differences. (4) There are signs of life in the commodity pits. (5) Global PMIs are mixed. (6) OECD leading indicators are awful. But are they accurate? (7) Is Germany a big canary? (8) Good and bad news for fans of Phillips curve tradeoff. (9) Wages rising fastest in industries that can't pass costs on into prices.

Global Economy: Frail & Feeble? The global economic outlook remains lackluster notwithstanding the continued ultra-easy monetary policies of the Bank of Japan and the European Central Bank. The People's Bank of China has recently joined their easing stances by lowering reserve requirements, thus boosting bank credit. The Fed has paused its rate-hiking. Fiscal policies have been stimulative too, as evidenced by government budget deficits around the world, with the US leading the way to even larger deficits.

The most obvious explanation for the global slowdown since last year is Trump's trade wars. But they aren't solely to blame. Our research has demonstrated that there are plenty of homegrown problems in most of the major economies. Nevertheless, uncertainty about trade may be exacerbating these problems. There's a good chance that the number-one trade conflict—i.e., between the US and China—will be resolved by the middle of this year. If so, that should result in a “peace dividend” that should revive global growth.

Furthermore, China's efforts to stimulate growth are fairly recent and may be only starting to work, as evidenced by the uptick in China's M-PMI during March. The Fed's decision in late March not to raise the federal funds rate again until maybe next year has only recently led to falling bond yields and mortgage rates. The rebounds in stock markets around the world since late last year have been led by cyclical stocks. That's a good omen for global growth over the rest of this year.

So Debbie and I are still expecting a modest cyclical rebound in global growth in coming months. However, we also see major structural issues continuing to weigh on global growth, namely, aging demographic trends and burdensome government debt.

We don't believe the global economy is heading into a recession. We do see similarities between the current environment and the 1990s. Back then, the US economy was strong, while the economies of Europe and Japan were weak. Different this time is that US economic growth is slower than it was in the 1990s. On the other hand, the emerging market economies hadn't even started to emerge during the 1990s, while they have plenty of room to do so in coming years.

In any event, like the Fed, we are data dependent, and the latest batch of global economic indicators remains mixed. Consider the following:

(1) *Accentuating a few positives: commodity prices and forward revenues.* Before we review the bad stuff, let's review the good stuff. Commodity prices have been firming up in recent days. The CRB raw industrials spot price index is up 2.2% ytd and back to one of the best readings since late August ([Fig. 1](#)). Another upbeat signal for the global economy is the rebound in the price of a barrel of Brent crude oil ([Fig. 2](#)).

Industry analysts around the world haven't received the recession memo. The forward revenues of the All Country World MSCI stock price index (in local currencies) rose to another record high during March ([Fig. 3](#)). Leading the way has been the US, though it has stalled in record-high territory so far this year, while the forward revenues of the rest of the world has been setting new record highs ([Fig. 4](#)).

(2) *Not so bad are the global PMIs.* March global PMIs were mixed. The C-PMI (i.e., the composite of the M-PMI and NM-PMI) edged up from 52.6 during February to 52.8 last month ([Fig. 5](#)). That's good.

Bad was the M-PMI for the advanced economies. It dropped to 50.0 during March. However, the M-PMI for the emerging economies rose from a recent low of 49.5 during January to 51.0 last month. So the global M-PMI came in at 50.6, which is still not so good.

Weighing most heavily on the global M-PMI is Germany's M-PMI, which fell to an abysmal low of 44.1 during March ([Fig. 6](#)). Of course, the big upside surprise last month was China's official M-PMI, which rose to 50.5, from 49.2 during February ([Fig. 7](#)).

(3) *Leading indicators are down to no good.* "Awful" is the only way to describe February's batch of OECD leading economic indicators. The overall index fell to 99.1, the lowest reading since October 2009 ([Fig. 8](#)). That doesn't jibe with the global C-PMI, which remained above the lows of 2016 so far this year through March.

The following leading indicators fell further below 100.0 (indicating economic contraction may be ahead) in February: China (98.3), UK (98.4), Canada (98.8), Europe (98.9), Japan (99.5), and US (99.1). Among the few readings above 100.0 were for Brazil (102.5) and India (100.7). (See our [Global Leading Indicators](#).)

While Debbie and I keep track of the OECD leading indicators, we tend to give more weight to other more timely and accurate global indicators. Among them is the Economic Sentiment Index for the Eurozone ([Fig. 9](#)). It is highly correlated with the region's real GDP growth rate (y/y). It fell to 105.5 during March, the lowest since October 2016, but still consistent with positive growth, though barely so.

(4) *There's no oomph in Germany's economy.* Germany isn't the canary in the coal mine. It is Big Bird, and croaking. The country's economy is very dependent on exports. The weakness in the latest German economic indicators has been breathtaking.

As we've previously observed, new environmental regulations on the auto industry have caused German auto production to fall into a ditch ([Fig. 10](#)). As a result, total factory orders plunged 4.2% m/m and 8.4% y/y during February ([Fig. 11](#)). Manufacturing output is down 1.7% y/y through February. The good news is that merchandise exports are down just 1.3% m/m and up 2.8% y/y, suggesting that Germany's recent economic problems are homegrown rather than reflective of a rapidly eroding global economy.

Inflation: Still MIA. Attention fans of the Phillips Curve model of inflation: It's not completely dead. "Better late than never" is the recent message from the curve. In the past, there was an inverse relationship between the unemployment rate and wage inflation, measured by using the y/y percentage

change in the average hourly earnings for production and nonsupervisory workers, who account for roughly 80% of all employees ([Fig. 12](#)).

During the current business cycle, the unemployment rate fell consistently from a high of 10.0% during October 2009 to a low of 3.7% during November 2018, but wage inflation was stuck around 2.0% from 2013-2017. It finally got going in 2018, when it rose from 2.5% at the beginning of the year to a cyclical high of 3.5% during February of this year. It edged down to 3.3% in March.

However, the upturn in wage inflation has yet to show up in the price inflation rate as measured by the core PCED ([Fig. 13](#)). The latter was just 1.8% y/y through January. It has been mostly below 2.0% since the mid-1990s.

Based on average hourly earnings for nonsupervisory workers, there are several industries where wage inflation is above the average rate of 3.3% y/y, including a few where rising labor costs aren't very likely to be passed through to prices. Here's a tally: wholesale trade (5.2%), information services (5.2), natural resources (5.1), and retail trade (4.8). These industries may be able to offset rising wage costs with greater productivity. Leisure & hospitality (4.7) stands out as one industry that might be able to raise prices to offset rising wage costs, especially since they aren't likely to be offset by productivity.

CALENDARS

US. Tues: NFIB Small Business Optimism Index 102.0, Job Openings 7.566m. **Wed:** Headline & Core CPI 1.8%/2.1% y/y, Monthly Budget Statement -\$200.0b, MBA Mortgage Applications. (DailyFX estimates)

Global. Tues: Japan Machine Orders 2.9%/m/-4.6%/y/y, Mexico Headline & Core CPI 4.0%/4.1% y/y. **Wed:** UK GDP 0.0%/m/0.2%3-month, UK Headline & Manufacturing Industrial Production -0.8%/-0.7% y/y, UK Trade Balance -£3900m, Japan Machine Tools, China New Yuan Loans ¥1225.0b, China Aggregate Financing ¥1985.0b, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.40%, Draghi, Kuroda. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose w/w for all of the market-cap indexes for a second week, possibly signaling an end to the downtrend that began in late October. LargeCap's has risen during six of the past eight weeks; MidCap's rose for a fourth straight week for the first time since mid-October; and SmallCap's second straight gain was its first back-to-back advance since late November. LargeCap's forward EPS is just 1.4% below its record high of \$175.48 in late October; MidCap's improved to 1.8% below its mid-October high from 2.6% a week earlier; and SmallCap's improved to 7.6% below its mid-October high from 8.1% below a week earlier. At their bottoms, LargeCap's forward EPS had been the most below its record high since June 2016, and MidCap's was the lowest since February 2016. SmallCap's had not been this far below since October 2010. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act, but tumbled as y/y comparisons became more difficult. But that may be ending soon too. In the latest week, the rate of change in LargeCap's forward earnings rose to 6.6% y/y from a 26-month low of 6.4% y/y. That's down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap's y/y change rose to 6.2% from a 27-month low of 6.0%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap's improved to 4.2% from 4.0% and is up from a 31-month low of 3.8% in late March, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been

expecting double-digit percentage earnings growth in 2019, but those forecasts have been dropping since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.5%, 12.0%), MidCap (22.7, 3.7, 12.5), and SmallCap (22.4, 4.5, 18.6).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios rose w/w for all these indexes and are well above their multi-year lows in late December. LargeCap's weekly forward P/E rose to a 28-week high of 16.7 from 16.4, which is up from a five-year low of 13.9 during December. That compares to a six-month high of 16.8 in mid-September and a multi-year high of 18.6 on January 26 (highest since May 2002)—and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week's level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's forward P/E rose 0.3pt to a 26-week high of 15.9. That's up from 13.0 during December, which was the lowest reading since November 2011. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. However, MidCap's P/E has been at or below LargeCap's P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap's P/E improved to a five-week high of 17.0 from 16.6, which is well above its seven-year low of 13.6 during December. That's still well below its 51-week high of 20.2 in December 2017 (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed). SmallCap's P/E was higher than LargeCap's P/E for a 12th straight week, after being below for much of December for the first time since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q1 books closed, analysts continued to trim their Q1 forecasts. Last week saw the S&P 500's Q1-2019 EPS forecast drop 5 cents w/w to \$37.29. That's down 7.1% since the end of Q4 and is the worst quarter for consensus forecast revisions since Q1-2016. The \$37.29 estimate represents a forecasted pro forma earnings decline for Q1-2019 of 2.2%, compared to -1.9% a week earlier and 5.3% at the end of Q4. If it comes to pass, Q1's y/y decline would be its first after 10 straight gains, and down from 16.8% in Q4 and 28.4% in Q3 (which marked the peak of the current earnings cycle). Just four of the 11 sectors are expected to record positive y/y earnings growth in Q1-2019, with none rising at a double-digit percentage rate. That compares to 10 positive during Q4, when seven rose at a double-percentage rate. Six sectors are expected to match or beat the S&P 500's Q1 growth rate, compared to just four during Q4. Utilities is the only sector expected to post better growth on a q/q basis during Q1. Here are the latest forecasted Q1-2019 earnings growth rates versus their Q4-2018 growth rates: Health Care (4.5% in Q1-2019 versus 13.3% in Q4-2018), Industrials (2.8, 27.0), Real Estate (2.5, 6.2), Financials (2.3, 15.6), Utilities (-0.3, -10.4), Consumer Staples (-2.1, 4.6), Consumer Discretionary (-3.5, 18.1), Communication Services (-5.7, 26.4), Information Technology (-6.1, 10.3), Materials (-15.3, 6.1), and Energy (-20.4, 81.4). On an ex-Energy basis, analysts expect S&P 500 earnings to drop 1.2% y/y in Q1, well below the 14.2% y/y gain in Q4 and the lowest ex-Energy growth rate since Q2-2016.

US ECONOMIC INDICATORS

Factory Goods Orders & Shipments ([link](#)): The manufacturing sector has lost momentum, facing headwinds from a softening in global demand, a trade war between the US and China, and a higher dollar. Still, both factory orders and shipments remained at relatively high levels in February. Manufacturing orders declined 0.5% after no change in January and a 0.1% uptick in December; these orders are 3.1% below September's cyclical high. Nondefense capital goods orders ex aircraft (a proxy for future business investment) ticked down 0.1% in February and is only 1.4% below July's cyclical high. Meanwhile, factory shipments climbed 0.4% in February, following a four-month slide of 1.1%; these shipments are within 0.8% of July's record high. Core capital goods shipments (used in calculating GDP) dipped 0.1% in February after reaching a new record high at the start of this year. ISM's M-PMI (to 55.3 from 54.2) showed an acceleration in manufacturing activity in March, including new orders (57.4 from 55.5), though new export orders (51.7 from 52.8) continued to deteriorate toward

the breakeven point of 50.0 as foreign demand continued to weaken.

GLOBAL ECONOMIC INDICATORS

Global Leading Indicators ([link](#)): In February, the OECD's composite leading indicators (CLIs)—designed to anticipate turning points in economic activity relative to trend six to nine months ahead—continued to anticipate an easing of growth momentum in most major economies, with the OECD's CLI (99.1) sinking to its lowest level since October 2009. Easing growth momentum remained the assessment for the US (99.1), Canada (98.8), Japan (99.5), the UK (98.4), and the Eurozone (99.2) as a whole—including Germany (99.2) and Italy (99.2), while France's CLI (99.1) now points to stabilizing growth momentum. Among emerging economies, growth gaining momentum remains the assessment in Brazil (102.5), while Russia's CLI (99.8) still points to easing growth momentum. Meanwhile, India (100.7) continues to anticipate stable growth momentum, with similar signs now emerging for the industrial sector in China (98.3).

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

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