



MORNING BRIEFING

May 20, 2019

Global Economy Dropping Like Lead?

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

(1) CRB raw industrials spot price index drops on escalating US-China trade war. (2) Another global growth recession, or worse? (3) Global forward revenues on uptrends. (4) Steel price down sharply as European auto production staggers in wake of new auto emissions standard. (5) Still expecting Chinese to cave. (6) Rail freight traffic stalling in China. (7) Six weeks from the longest US economic expansion on record. (8) Home, sweet home. (9) The Fed's semi-existential crisis. (10) Fed Governor Brainard says Phillips curve is not flat but broken. (11) Brainard begs to differ with her colleagues on low inflation: It may not be transient.

Global Economy: Trade Isn't the Only Problem. The escalation of the trade war between the US and China over the past couple of weeks is weighing on the global economy. We can see this in our trusty CRB raw industrials spot price index, which fell to 464 last week, its lowest reading since 10/27/2016 ([Fig. 1](#)). It's still above its low of 398 on 11/23/15, which marked the bottom of the global growth recession of mid-2014 through early 2016.

So is another global growth recession, or even an outright recession, under way? Debbie and I think that the first scenario is a greater risk for the global economy than the second one, but the recent drop in commodity prices is a concern, for sure. On the other hand, our relatively optimistic outlook for continued, slow-but-steady growth is confirmed by the ongoing ascent in the weekly forward revenues (in local currencies) of the MSCI stock indexes for the US, Developed Economies ex-US, and emerging markets ([Fig. 2](#)).

Let's have a closer look:

(1) *Weak steel.* The recent drop in the CRB index has been led by its metals component, which includes scrap copper, lead scrap, steel scrap, tin, and zinc ([Fig. 3](#)). Interestingly, the price of copper, which is particularly sensitive to the Chinese economy, has been holding up better than the other metals prices ([Fig. 4](#)). The price of lead is rapidly approaching its late 2015 low ([Fig. 5](#)).

At \$641 per short tonne, the steel price component of the CRB is still well above its low of \$364 near the end of 2015 ([Fig. 6](#)). But it is down 31% from last year's high of \$924 on 6/4. This may reflect the weakness in European auto production more than the slowdown in China's spending on infrastructure and other fixed assets.

(2) *Europe's climate-change auto recession.* As Debbie reports below, the 12-month sum of new passenger car registrations in the European Union dropped 5% from last year's high of 15.8 million units during August to 15.0 million units during April ([Fig. 7](#)).

As we've noted previously, the weakness in European auto sales coincided with the Worldwide Harmonized Light Vehicle Test Procedure (WLTP) for auto emission standards.

Some automakers were unprepared for the difficulties of WLTP certification (which is lengthier than previous certification tests and closely mimics real-world conditions) when WLTP for passenger cars took effect last September, and those models not certified by the deadline were temporarily taken off the market. Sales slumped after September following a spring/summer rush to move noncompliant vehicles from dealer lots. Now the big rush is on to meet the 9/1/19 deadline for certifying all models and variants under the EU's new WLTP protocol.

Germany has been particularly hard hit. The 12-month sum of German auto production plunged nearly 10% from 5.4 million units last August to 4.9 million units in April ([Fig. 8](#)). We presume that European automakers will be WLTP compliant by September and that auto sales will improve later this year.

(3) *The Great Stall of China*. China's economy was slowing before President Donald Trump slapped a 10% tariff on \$200 billion of Chinese imports last September. He just raised that to 25%, and is likely to impose the same tariff on the remainder of the \$300 billion that the US imports annually from China. We've contended that the slowdown in China is mostly attributable to homegrown problems over there, including too many old people, too many zombie businesses, and too much debt.

However, Trump's tariffs will exacerbate China's slowdown. A protracted trade war with the US is bound to convince more manufacturers to leave China for countries that don't have a 25% penalty fee imposed on their exports to the US. That's why we expect that the Chinese will cave and do a deal with Trump despite their increasingly hostile rhetoric toward the US.

Meanwhile, one of the more accurate indicators of the Chinese economy has stalled in recent months. The 12-month moving average of China's rail freight traffic has been moving sideways for the past three months through March ([Fig. 9](#)). This series is highly correlated with the 12-month moving average of the sum of Chinese imports plus exports, which has also flattened in recent months (in yuan) ([Fig. 10](#)).

(4) *US economy continues to expand*. Here in the US, April's retail sales and industrial production started Q2 on a weak note. However, as Debbie reviews below, May's readings from the regional business surveys conducted by the Federal Reserve banks of New York and Philadelphia are upbeat.

Furthermore, the Index of Leading Economic Indicators rose 0.2% during April. That suggests that the US economic expansion will continue for at least another three to six months ([Fig. 11](#)). If so, then come July, it will be the longest one ever. On the other hand, the Index of Coincident Economic Indicators, which rose to yet another record high during April, is up only 1.8% y/y, suggesting that real GDP growth may be slowing ([Fig. 12](#)).

(5) *Stay Home vs Go Global*. In any event, our Stay Home investment strategy continues to outperform the Go Global alternative ([Fig. 13](#)). Here is the ytd performance derby of the major MSCI stock price indexes (in local currencies): United States (14.3%), EMU (13.2), World (11.9), United Kingdom (8.7), and Japan (4.6) and Emerging Markets (4.5) ([Fig. 14](#)).

Here is the performance derby over the past two weeks, when the US-China trade war escalated: United Kingdom (-0.3%), EMU (-2.6), United States (-2.9), World (-3.2), Japan (-3.8), and Emerging Markets (-7.1).

The Fed: Crisis of Confidence. "The picture on inflation is puzzling this far into an expansion," Fed Governor Lael Brainard said in a 5/16 [speech](#) at the National Tax Association's Spring Symposium in Washington. Indeed, the PCED inflation rate has mostly hovered below the Fed's 2.0% target since 2012. Meanwhile, unemployment has reached historical lows. And the US economic expansion is

poised to become the longest on record, assuming it reaches its ten-year milestone during July.

Brainard has long argued, since the days when Janet Yellen was Fed chair, that waiting “until the whites of inflation’s eyes appear” to raise interest rates would be prudent. Once again she made that argument, but any hint of confidence that she may have once had in inflation’s return seems to have been shaken by the long wait.

She once said, during Yellen’s tenure, that the inverse relationship between inflation and unemployment had “flattened.” Now she says that the relationship “appears to have broken down.” Her latest speech was aptly titled: “The Disconnect between Inflation and Employment in the New Normal.” Here’s more:

(1) *Crisis of non-consensus.* Following Fed Chair Jerome Powell’s 5/1 [press conference](#), Melissa and I refuted his assessment that the recent stretch of low inflation is “transitory.” (See our 5/6 [Morning Briefing](#).) Fed Governor Brainard, who once seemed to influence Yellen’s thoughts, doesn’t seem as influential over Powell, though they have served on the Federal Reserve Board of Governors together since Brainard was appointed during 2014. In her speech, Brainard directly countered Powell’s rationale, saying: “As I have argued in the past, the fact that inflation has been running somewhat below our longer run goal of 2 percent may not be entirely due to labor market slack or transitory shocks.”

(2) *Crisis of conscience.* Fed officials have two big problems with low inflation. First, it precludes them from raising interest rates enough to create a solid buffer for the economy in the event of a future downturn. Second, financial market participants’ doubts about the Fed’s ability to achieve its 2.0% target are weighing on inflation expectations. Some Fed officials blame themselves. In [prepared remarks](#) on 5/16, Minneapolis Fed President Neel Kashkari said: “For our current framework to be effective and credible, we must walk the walk and actually allow inflation to climb modestly above 2 percent.”

(3) *Crisis of commitment.* Most officials seem unwilling to cut rates to achieve the target. But some seem willing to patiently await inflation’s return and even allow it to overshoot the target for a time. In her speech, Brainard seemed to advocate for a mild overshoot of the inflation target for a “couple of years” to restore confidence in the economy. She even believes that a potential run-up in import prices caused by the US-China trade dispute would be well tolerated without the need to raise rates. “The Federal Reserve could use that opportunity to communicate that a mild overshooting of inflation is consistent with our goals and to align policy with that statement,” she said.

(4) *Crisis of change.* As we’ve previously discussed, the Fed is undergoing a review of its approach to monetary policy. At the core of the discussions is the inflation conundrum. The solution with the most traction so far is average inflation targeting, whereby the Fed would seek an average inflation rate over a period of time, making up for “misses” that may have occurred with future “overshoots” that average inflation levels out. Absent changes like this, “central banks will be severely challenged to achieve stable economies and well-anchored inflation expectations,” New York Fed President John C. Williams said in a 5/14 [speech](#) in Zürich.

CALENDARS

US. Mon: Chicago Fed National Activity Index, Powell, Williams, Clarida. **Tues:** Existing Home Sales 5.35mu, Evans, Rosengren. (DailyFX estimates)

Global. Mon: Japan Industrial Production. **Tues:** Eurozone Consumer Confidence -7.7, Japan Trade

Balance ¥229.5b, Japan Machine Tool Orders 0.0%_{m/m}/-3.5%_{y/y}, OECD Publishes Economic Outlook, RBA Minutes of May Policy Meeting, Lowe, Carney, Guindos. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index fall 0.8% to 2.9% below from its record high on May 3, its first since 9/20. That performance ranked 23rd among the 49 global stock markets we follow in a week when 13/49 countries rose in US dollar terms. That compares to the prior week's 15/49 ranking, when the US MSCI fell 2.2% as four markets rose. The AC World ex-US index fell 0.9%; that performance compares to a 3.2% drop a week earlier, which was its biggest decline since late October. EM Eastern Europe was the best performer with a gain of 1.7%, followed by EMU (0.5%), EMEA (0.1), and EAFE (0.0). The regions underperforming last week: EM Latin America (-4.9), EM Asia (-3.8), and BRIC (-3.2). Russia was the best-performing country, rising 3.1%, followed by Switzerland (1.9), Spain (1.4), and Finland (1.3). Of the 22 countries that underperformed the AC World ex-US MSCI last week, Indonesia fared the worst, falling 8.3%, followed by Brazil (-6.9), Pakistan (-6.8), Chile (-5.3), and Taiwan (-5.3). The US MSCI's ytd ranking dropped two places last week to 6/49 last week, with its 14.3% ytd gain ahead of that of the AC World ex-US (7.6). Nearly all regions and 34/49 countries are in positive territory ytd. Among the regions, three are outperforming the AC World ex-US ytd: EMU (10.6), EM Eastern Europe (9.1), and EAFE (8.5). Regions underperforming the AC World ex-US: EM Latin America (-1.5), EMEA (3.1), EM Asia (3.8), and BRIC (6.7). The best country performers ytd: Egypt (16.5), Canada (16.2), Russia (15.9), New Zealand (15.1), and the Netherlands (15.1). The worst-performing countries so far in 2019: Turkey (-17.5), Sri Lanka (-10.5), Indonesia (-9.7), Chile (-8.2), and Pakistan (-8.0).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes fell for a second straight week; LargeCap's 0.8% drop was better than the declines recorded by MidCap (-2.3%) and SmallCap (-3.1). LargeCap ended the week 2.9% below its record high at the end of April. MidCap dropped to 7.8% below its August 29 record high, but SmallCap moved deeper into a correction at 14.9% below its August 29 record. Among the 33 sectors, seven moved higher last week compared to just one rising a week earlier. The best performers in the latest week: LargeCap Real Estate (1.4%), LargeCap Utilities (1.2), LargeCap Consumer Staples (0.9), and MidCap Real Estate (0.4). SmallCap Communication Services (-4.7) and SmallCap Materials (-4.7) were the biggest decliners, followed by SmallCap Tech (-4.6), MidCap Tech (-3.9), and SmallCap Consumer Discretionary (-3.6). In terms of 2019's ytd performance, all three indexes are still off to a great start. However, LargeCap now leads with a gain of 14.1% ytd, ahead of MidCap (13.6) and SmallCap (10.6). All 33 sectors are positive ytd, with the cyclicals leading the top performers: LargeCap Tech (21.3), MidCap Tech (19.7), LargeCap Communication Services (18.7), and MidCap Communication Services (18.7). LargeCap Health Care (2.1) has the smallest gain so far in 2019, followed by these underperformers: SmallCap Health Care (3.6), SmallCap Consumer Staples (6.2), and SmallCap Communication Services (7.5).

S&P 500 Sectors and Industries Performance ([link](#)): Four of the 11 S&P 500 sectors rose last week as six outperformed the S&P 500's 0.8% decline. That compares to all 11 falling a week earlier for the first time in 20 weeks, when six outperformed the S&P 500's 2.2% decline. Real Estate was the best-performing sector with a gain of 1.4%, ahead of Utilities (1.2%), Consumer Staples (0.9), Communication Services (0.3), and Health Care (-0.5). Last week's biggest underperformers: Financials (-2.1), Industrials (-1.9), Consumer Discretionary (-1.1), Tech (-1.1), and Materials (-0.8). All 11 sectors are higher so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These six sectors have outperformed or matched the S&P 500's 14.1% rise ytd: Information Technology (21.3), Communication Services (18.7), Real Estate (17.7), Consumer Discretionary (17.7), and Industrials (16.1). The ytd laggards: Health Care (2.1), Materials (8.0), Energy (10.4), Utilities (10.6), Financials (12.5), and Consumer Staples (13.7).

Commodities Performance ([link](#)): Last week, the S&P GSCI index rose 2.0% as 15 of the 24 commodities moved higher. That was the index's first gain in five weeks and compares to a 1.5% decline a week earlier, when five commodities moved higher. The index nearly climbed out of a correction during mid-April, with a drop of just 10.0% from its high in early October after being down as much as 26.9% from that high on December 24. It has since weakened to 11.8% below its October high. Wheat was the strongest performer for the week, as it rose 9.5%, ahead of Corn (9.0%), Kansas Wheat (8.6), Unleaded Gasoline (2.9), and GasOil (2.9). Cotton was the biggest decliner, with a drop of 3.6%, followed by Silver (-2.7), Coffee (-2.0), Sugar (-1.5), and Copper (-1.1). The S&P GSCI commodities index is up 18.3% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Unleaded Gasoline (55.0), Lean Hogs (52.5), Crude Oil (38.6), Brent Crude (32.5), and GasOil (27.5). The biggest laggards in 2019: Kansas Wheat (-14.0), Coffee (-12.6), Live Cattle (-12.1), Lead (-9.7), and Natural Gas (-9.4).

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index fell 0.8% last week and weakened relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). The index's 50-dma relative to its 200-dma improved for a 14th straight week to a 30-week high, and the index was in a Golden Cross for an eighth week after being in a Death Cross for 16 weeks. It had been in a Golden Cross for 137 weeks through late November, and its previous Death Cross lasted for 17 weeks through April 2016 (when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016). The current Golden Cross reading of 3.7% is up from 3.4% a week earlier and from -5.2% in early February, which had matched the lowest reading since November 2011. It's still down from a 55-month high of 7.2% in February 2018. The S&P 500's 50-dma rose for the 15th time in 16 weeks, after falling for 16 straight weeks in its worst downtrend since before the 2016 election. However, the index tumbled to an 18-week low of 0.4% below its rising 50-dma from 0.6% above its rising 50-dma a week earlier, and is down from 6.6% during mid-February, which was its highest since October 2011. That compares to a seven-year low of 12.0% below at the end of December. The 200-dma rose for a 16th week after falling in 11 of the prior 15 weeks in the first downtrend since May 2016, when it had been slowly declining for nine months. However, it dropped to a seven-week low of 3.2% above its rising 200-dma from 4.0% and is down from a 32-week high of 6.4% at the beginning of May. That compares to 14.5% below its falling 200-dma on December 24, which was the lowest since April 2009. However, it remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators ([link](#)): Five of the 11 S&P 500 sectors traded above their 50-dmas last week, down from eight a week earlier. Consumer Discretionary and Tech fell below that moving average for the first time since mid-January and Industrials for the first time in nine weeks. Materials was below for a second week, Energy for a fourth, and Health Care for a sixth. Still, that's an improvement from early January when all 11 were below. The longer-term picture—i.e., relative to 200-dmas—shows eight sectors trading above currently, unchanged from a week earlier. Materials was below its 200-dma for a second week, Energy for a 32nd week, and Health Care for a sixth week. Nine sectors are in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier and the highest count since early November. Financials has been back in a Golden Cross for just three weeks, while Health Care was out for a third week and Energy for a 27th week. All 11 sectors had been in a Golden Cross in January 2018 (for the first time since a 26-week streak ended in October 2016). Nine sectors now have rising 50-dmas, unchanged from a week earlier. Energy's 50-dma fell for a third week and Health Care's for a sixth week after mostly rising since mid-2016. Seven sectors have rising 200-dmas, unchanged from a week earlier as Health Care fell for a second week. Among the remaining laggards: Energy, Financials, and Materials have had mostly falling 200-dmas for about eight months now, which compares to just two sectors with rising 200-dmas in early January in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.

US ECONOMIC INDICATORS

Leading Indicators ([link](#)): April's Leading Economic Index (LEI) advanced for the third month, to yet another record high, with seven of the 10 components contributing positively to last month's gain. The LEI increased 0.2% in April following gains of 0.3% and 0.2% the prior two months. Stock prices (+0.14ppt), the leading credit index (+0.10), and consumer expectations (+0.07) buoyed the LEI in April, though the manufacturing sector showed continuing weakness—with the ISM new orders index (-0.08) and real core capital goods orders (-0.01) recording the only negative contributions last month; the average workweek for manufacturing was unchanged. The LEI is up 2.8% y/y, slowing steadily from September's 6.6%—which was the strongest since February 2011. The Conference Board expects economic growth to moderate toward 2.0% by year-end. The current expansion will enter its 11th year in July, becoming the longest expansion in US history.

Coincident Indicators ([link](#)): The Coincident Economic Index (CEI) in April continued to reach new record highs, though the pace has slowed in recent months. April saw the CEI tick up 0.1% for the second month, after showing a 0.1% dip in February—which was only the second decline recorded in the index since July 2013. The CEI is up 1.8% y/y, slowing from 2.4% in January. Three of the four components contributed positively in April, while industrial production was a drag on the LEI for the third time this year. Here's a look at the components: 1) Employment was once again the biggest contributor to the CEI, as April hirings blew past forecasts, with companies adding 263,000 (vs 185,000 forecast)—considerably above 2018's average monthly gain of 223,250. 2) Real personal income—excluding transfer payments—in April was only fractionally below December's record high, expanding 0.2% after a 0.2% loss and a 0.1% gain the previous two months; sales had contracted 0.6% in January. 3) Real manufacturing & trade sales increased for the fifth time in six months—by 0.2% in April and 1.7% over the six-month period—to a new record high. 4) Industrial production contracted 0.5% in April and 1.2% ytd, to its lowest level since last July. Factory output slumped 0.5% and 1.6%, respectively, over the comparable periods, to its lowest reading since last May.

Consumer Sentiment ([link](#)): A surge in expectations boosted consumer sentiment to its highest reading in 15 years in mid-May—though the “gains were recorded mostly before the trade negotiations with China collapsed and China responded with their own tariffs,” according to the University of Michigan's report. The Consumer Sentiment Index jumped from 97.2 in April to 102.4 in mid-May—the highest since January 2004, as the expectations component soared 8.6 points to 96.0. The report notes: “To be sure, negative references to tariffs rose in the past week and are likely to rise further in late May and June. Those who held negative views about the impact of tariffs on the economy and pricing had values on the Expectations Index that were 25 points lower, and expected the year-ahead inflation rate to be 0.6 percentage points higher.” Meanwhile, the present situation component was basically unchanged at 112.4, an uptick from April's 112.3.

Regional M-PMIs ([link](#)): Both Fed districts that have reported on manufacturing activity for May so far—Philadelphia and New York—show growth accelerated at its fastest pace in seven months. We average the composite, orders, and employment measures as data become available. The composite (to 17.2 from 9.3) index showed growth was nearly double the pace of April, accelerating steadily from February's 2.4—which was the slowest since October 2016. The New York region's composite (17.8 from 10.1) measure posted its best growth this year, while Philadelphia's (16.6 from 8.4) rebounded back toward its 2019 high of 17.0 at the start of the year; the index had contracted in February. The new orders gauge (10.4 from 11.6) held around April's rate, after being near the breakeven point of zero in February and March. Orders in the New York (9.7 from 7.5) region accelerated at its best pace of 2019, while Philadelphia's (11.0 from 15.7) slowed, though was still faster than New York's rate. Meanwhile, the employment index (11.5 from 13.3) eased a bit this month, though remained above

January's 17-month low of 8.5; it was a mixed bag. Factories in Philadelphia (18.2 from 14.7) added to payrolls at the best pace since the end of last year, while New York's (4.7 from 11.9) growth in May was among the weakest for that region in two years.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI ([link](#)): April's CPI rate confirmed the flash estimate, remaining below 2.0% for the sixth consecutive month, while the core rate moved back above 1.0%. The headline rate climbed to 1.7% y/y (from 1.4% in March); it eased steadily from a six-year high of 2.3% in October to a nine-month low of 1.4% in January. Looking at the main components, energy (unchanged at 5.3% y/y) once again recorded the highest annual rate in April, up from a recent low of 2.7% at the start of the year. Meanwhile, the remaining components showed an acceleration in services (to 1.9% from 1.1%) inflation and a slowing in food, alcohol & tobacco (1.5 from 1.8), while the rate for non-energy industrial goods (0.2 from 0.1) continued to hover just above zero. The core rate—which excludes energy, food, alcohol, and tobacco—climbed to 1.3% y/y after falling to 0.8% y/y in March, which was the lowest since last April. Of the top four Eurozone economies, Germany's (2.1% y/y) rate was above April's 1.7% headline rate, while rates in Spain (1.6) and France (1.5) were below. Italy (1.1) had one of the lowest rates, along with Greece (1.1) and Portugal (0.9).

European Car Sales ([link](#)): EU passenger car registrations (a proxy for sales) for April fell for the eighth straight month y/y, ever since the introduction of the Worldwide Harmonized Light Vehicle Test Procedure (WLTP) last September, though has narrowed to near zero. Sales fell 0.4% y/y in April, though sales in three of the EU's five major markets turned positive last month—Spain (2.6% y/y), Italy (1.5), and France (0.4)—while the UK (-4.1) and Germany (-1.1) remained in the red. Demand in the region was mainly driven the Central European Economies, which posted a 4.6% y/y gain. Sales during the first four months of 2019 fell 2.6% from the comparable period a year ago. Among the major markets, Germany (-0.2% y/y) and France (-0.4) were basically flat with a year ago, while Italy (-4.6) Spain (-4.5) posted the steepest sales' declines; UK sales were 2.7% below a year ago.

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