



MORNING BRIEFING

June 11, 2019

Global Scorecard

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

(1) Spreading soft patch. (2) Easing does it for a while longer. (3) Trump will make or break the global outlook. (4) Famous last words: There will be peace in our time. (5) No rush to leave home and go global. (6) Using China's trade data to assess the global economy. (7) Still looking like a slowdown rather than a downturn. (8) Europe has problems. (9) Some important soft patches in US. (10) *Beige Book* is neither red nor green.

Global Economy I: Soft Patches. The latest global economic soft patch is getting softer, and may be spreading to the US economy. Trump's escalating trade war with China may be contributing to this development, but many key economies have plenty of homegrown problems that are weighing them down and contributing to slower global economic growth, as we have previously discussed. It all leads to the conclusions that global inflation will remain subdued and interest rates will remain low as the major central banks maintain their ultra-easy monetary policies, as we discussed yesterday.

The question is whether all this is leading to a global recession with bear markets in stock prices around the world. The answer is most likely "yes" if President Trump's trade war with China escalates to the extent that he slaps a 25% tariff on all \$500 billion of Chinese goods imported into the US. If a deal is struck this summer, as we expect, then there could very well be a "peace dividend" that boosts global economic growth. At the beginning of May, Trump raised the 10% tariff on \$200 billion of such goods to 25%.

The continuation of ultra-easy monetary policies by the European Central Bank and the Bank of Japan, as well as the possible resumption of monetary easing by the Fed, aren't likely collectively to boost economic growth much, since they seem to have lost much of their effectiveness. But the flow of central bank liquidity is likely to push asset prices still higher, especially in the US. Indeed, a melt-up in stock prices once again is a possibility.

In any event, Stay Home may very well continue to outperform Go Global ([Fig. 1](#)). The US MSCI is up 14.9% ytd through Friday's close versus gains of 8.3% in both dollars and local currency for the All Country World ex-US MSCI. The trade-weighted dollar is up 3.4% y/y and less than 0.1% ytd despite all the chatter about Fed rate cuts ahead ([Fig. 2](#)). The dollar tends to be strong when the US economy is doing better than the economies of the rest of the world.

Here is the performance derby of the major MSCI stock price indexes ytd through Friday in local currencies: US (14.9%), All Country World (11.9), EMU (11.3), UK (8.5), Emerging Markets (5.1), and Japan (3.1) ([Fig. 3](#)). Here is the same in US dollars: US (14.9), All Country World (11.9), EMU (10.4), UK (8.6), Japan (4.7) and Emerging Markets (4.3) ([Fig. 4](#)). Now let's review a few of the key topline indicators of global economic activity:

(1) *Commodity prices.* There's a strong inverse correlation between the trade-weighted dollar and

commodity prices. The CRB raw industrials spot price index fell to a new low for this year at the end of last week ([Fig. 5](#)). It is back to the lowest reading since 9/26/2016. The price of a barrel of Brent crude oil is down 15% from this year's peak of \$74.57 on 4/24 through Friday ([Fig. 6](#)).

(2) *Global production and exports*. Global industrial production growth fell to 1.6% y/y during March. That's down from a recent peak of 4.1% during February 2018. That's one of the weakest rates (behind February's 1.2%) since December 2015, but more like a growth recession than a full-fledged downturn.

The growth in the volume of world exports is highly correlated with global industrial production growth. The former turned slightly negative from December 2018 through February, but it was up 2.1% y/y during March ([Fig. 7](#)). Industrial production in the 36 economies of the OECD rose just 0.2% y/y during March ([Fig. 8](#)).

(3) *Global PMIs*. It's spring, and there isn't much growth in the global economy. That's confirmed by May's global PMIs. The global composite (C-PMI) was only 51.2 last month, the weakest since June 2016, with the C-PMIs at 51.1 for advanced economies and 51.3 for emerging ones ([Fig. 9](#)).

The global NM-PMI managed to remain above 50.0 at 51.6, but that was the weakest since August 2016.

Global Economy II: Chinese Trade. What happens in China doesn't stay in China. The country's Three Gorges Dam was completed during 2012. It is massive. When the dam is at its maximum capacity, the reservoir holds 42 billion tons of water. According to a 1/28 [article](#) posted on Interesting Engineering, "[a] shift in mass that size does affect Earth, increasing the length of a day by 0.06 microseconds." To my knowledge, no one (not even Alexandria Ocasio-Cortez [D-NY]) has considered the possibility that this phenomenon may be the cause of climate change.

Similarly, as China's economy has grown to the second largest in the world, it has been having a significant impact on global economic activity. As the former has slowed, so has the latter. A good proxy for this phenomenon is to track the growth rate in the sum of Chinese merchandise exports and imports (in yuan). During May, it was down to 5.2% y/y, based on the three-month average. The recent peak in this data series was 19.7% during October ([Fig. 10](#)). Let's have a closer look:

(1) *Total imports and exports*. Chinese imports (in yuan) is down 2.9% y/y, while exports is up 7.7% ([Fig. 11](#)). Both have been stalled at record-high levels since late last year, suggesting that growth has slowed to a crawl in China and the rest of the world so far this year.

(2) *Exports by destination*. The 12-month sums of Chinese exports (in yuan) shows that they have stalled at a record high around 3.2 trillion yuan to the US so far this year, but climbed to a new record high of 2.9 trillion yuan to the European Union (EU) ([Fig. 12](#)). Also climbing to a new record high of 8.5 trillion yuan was exports to emerging markets, defined as total exports less those to the US, EU, Japan, South Korea, Taiwan, and Australia ([Fig. 13](#)).

On balance, China's exports data suggest that the global economy may be slowing, but it is still growing.

Global Economy III: Eurozone. Europe and China both face rapidly aging demographic profiles, which are weighing on their economies. These are among the homegrown problems they face. The European Union is facing an existential crisis as Brexit Day approaches and nationalist parties gain political power throughout the region. Italy's budget crisis is worsening (again), creating another source of stress for European unification. Consider the following:

(1) *German factories.* Germany is Europe's largest economy and is most visibly showing the stress cracks. During April, manufacturing output fell 2.5% m/m to the lowest since January 2017, while exports plunged 3.7% m/m to the lowest since February 2018 ([Fig. 14](#)). It's not all bad news: Factory orders edged up 1.1% during the two months through April, though that's from the lowest reading since January 2017.

(2) *Retail sales.* Also in the good-news column is that the volume of retail sales excluding autos and motor cycles in the Eurozone is at or near recent record highs for the region, led by France and Germany ([Fig. 15](#)).

New passenger car registrations have been very weak in the EU since last September, when tougher fuel-emission standards were imposed. The auto industry wasn't prepared for the change and had to slash production. A recovery in both auto output and sales is likely to start this coming fall.

(3) *Real GDP.* Below, Debbie reports that real GDP in the Eurozone rose 1.6% (saar) during Q1, improving steadily from Q3's 0.5%, which was the weakest since Q1-2013. Real GDP growth was up 1.2% y/y. This series is highly correlated with the region's Economic Sentiment Indicator, which ticked up ever so slightly during May following 10 months of consecutive declines ([Fig. 16](#)).

Friday's production and export figures from the Statistics Office suggested German GDP growth would slow or even stall in the current quarter, and the Bundesbank slashed its growth forecast for all of 2019, which as recently as December stood at 1.6%, to just 0.6%.

US Economy I: Good Place? Both Fed Chairman Jerome Powell and Vice Chairman Richard Clarida recently said that the US economy is in a "good place." So why have both of them recently also suggested that the Fed may have to lower interest rates to keep it in this good place? Apparently, they are concerned that Trump's trade wars could weaken the economy, and frustrate their efforts to boost the PCED inflation rate to 2.0%.

Furthermore, recently released data for April show that some areas of the economy were weakening even before the trade war escalated in early May. Debbie and I blamed it on bad weather, but available May indicators show more weakness, possibly exacerbated by the trade war. We expected more growth in the spring, but it hasn't arrived so far. Here are a few more thoughts on this subject:

(1) *Labor market.* Yesterday, we put a relatively positive spin on May's weak employment data, concluding that it might reflect a shortage of workers rather than a drop in the demand for them. The decline in the labor force so far this year is exacerbating the labor shortage. So why aren't wages rising faster? They are rising faster than price inflation, which is being subdued by the "4Ds," Demography, Debt, Disruption, and Deflation (see yesterday's [Morning Briefing](#)). Productivity may also be making a comeback as a response to tighter labor markets. Yesterday's JOLTS report showed that, during April, job openings exceeded unemployed workers by 1.6 million ([Fig. 17](#)).

(2) *Manufacturing and intermodal containers.* The US economy's soft patch seems to be concentrated in the manufacturing sector. During April, industrial production was up only 0.9% y/y, the weakest growth since February 2017 ([Fig. 18](#)). Interestingly, this series is highly correlated with rail car loadings of intermodal containers, which is down 1.0% y/y (based on the 26-week moving average, for smoothing purposes).

(3) *Housing.* The housing industry's foundation has been on soft ground since the start of the current expansion. Housing starts is up sharply since the depths of the industry's 2008-2010 depression ([Fig.](#)

[19](#)). However, it has stalled over the past couple of years at levels that are closer to previous cyclical troughs than peaks!

US Economy II: Neither Red nor Green. Last week, the Fed released May's [Beige Book](#), a compilation of anecdotes from the Fed's regional business contacts. Melissa noticed that trade tensions and labor shortages were the top two concerns. The word "tariff" was mentioned 37 times, up from 19 in April's [report](#). The latest report covered comments through 5/24, which was even before Trump's recent tariff threats to Mexico and the subsequent "deal" with the country. The words "shortage" or "constraint" as related to labor were mentioned 9 times in April's report, increasing to 12 times in May's.

The May report wasn't all bad, however, as growth was reported to have slightly improved from the last update nationwide: "Almost all Districts reported some growth, and a few saw moderate gains in activity." Melissa had a closer look at the two key issues that may be causing businesses to proceed with caution throughout the country:

(1) *Trade*. So far, the impact of heightened trade tensions on businesses was noted as follows (including by region): delayed business investment (Atlanta, Philadelphia), dampening of business sentiment/outlooks and increasing uncertainty (Boston, Dallas, New York), higher input prices now and/or expected from the tariffs (Boston, Chicago, Cleveland, Dallas, New York, Philadelphia, Richmond, San Francisco), softening manufacturing activity (Cleveland, Richmond, St. Louis), and negative impacts to specific sectors such as retailers and auto dealers (Atlanta), semiconductors (Boston), and agricultural firms (Dallas, St Louis, and San Francisco). Trade also had some impact on hiring. Contacts in Boston, for example, were slow to hire full-time employees, preferring temporary workers to fill the gaps while businesses waited out trade uncertainty.

But the commentary on trade was not all bad. For example, service-sector contacts in Dallas "indicated a downshift in demand growth if there is not a resolution to the trade dispute with China, although a few were optimistic that an agreement would be reached and benefit the U.S. long term."

(2) *Labor shortages*. Difficulty finding workers was cited among many regions as weighing on growth and business sentiment. Yesterday, we discussed how this anecdotal evidence of the labor-market tightness is showing up in the jobs data. According to the May report, nationwide "stronger employment growth continued to be constrained by tight labor markets, with Districts citing shortages of both high- and low-skill workers." The labor shortages span across not only worker skillsets but also industries.

In Dallas, the "shortage of truck drivers continued, and the construction labor market remained tight." In Kansas City, "[a] majority of contacts continued to report labor shortages for low- and medium-skill workers, including sales representatives, truck drivers, construction workers, and hourly retail and restaurant positions. A few respondents also noted shortages in high-skill occupations such as physicians, pilots, accountants, and IT professionals." In San Francisco, the labor market remained tight, "with persistent worker shortages reported across various skill levels and industries." In St. Louis, "labor market tightness persisted across several industries, including, but not limited to, transportation, construction, and healthcare. Furthermore, multiple manufacturing contacts reported that the shortage of qualified workers has worsened."

CALENDARS

US. Tues: NFIB Small Business Optimism Index 101.9, PPI-FD Total, Core, and Core Ex Trade Services 0.1%/0.2%/0.2%. **Wed:** Headline & Core CPI 1.9%/2.1% y/y, MBA Mortgage Applications, Monthly Budget Statement, DOE Crude Oil Inventories. (DailyFX estimates)

Global. Tues: UK Employment Change & Unemployment Rate (-1k (3m/3m)/3.8% (3m), UK Average Weekly Earnings Total & Ex Bonus (3m) 3.0%/3.1% y/y, UK Jobless Claims Change & Claimant Count Rate, China Direct Investment, Mexico Industrial Production. **Wed:** China CPI & PPI 2.7%/0.6% y/y, Draghi, Guindos. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose for all three indexes for a second week as LargeCap's was higher for an eighth straight week and at a record high for the first time since late October. The recent trend has been positive: LargeCap's has risen during 14 of the past 17 weeks; MidCap's 10 of the past 13 weeks; and SmallCap's eight of the past 11 weeks. While LargeCap's forward EPS is at a record high, MidCap's and SmallCap's are 1.2% and 6.3% below their mid-October highs. 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 May 2015. 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. In the latest week, the rate of change in LargeCap's forward earnings was steady at 4.6% y/y, just above the 29-month low of 4.5% in mid-May. That's down from 23.2% in mid-September, which was the highest since January 2011. MidCap's y/y change dropped to a 33-month low of 3.3% from 4.4%, which compares to 24.1% in mid-September (the highest since April 2011). SmallCap's is the lowest since January 2010, falling w/w to 0.2% from 2.0%. That compares to an eight-year high of 35.3% in early October. Analysts had been expecting double-digit percentage earnings growth for 2019 last October, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.0%, 11.8%), MidCap (22.7, 1.6, 14.0), and SmallCap (22.4, 2.8, 18.6).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios surged for the first time in five weeks for these indexes. LargeCap's weekly forward P/E rose to 16.4 from an 18-week low of 15.7, which compares to a 13-month high of 16.9 in early May and is up from a five-year low of 13.9 during December. That also compares to a 16-year high of 18.6 during January 2018—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 gained 0.7pt to 15.4 from a 20-week low of 14.7. That's down from a seven-month high of 16.3 in early April, but 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 of 16.0 was up 0.5pt w/w from a 20-week low, 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 a tad below LargeCap's P/E for a third 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 Q2 earnings season set to begin in less than a month, analysts are no doubt contemplating the trade war's impact on earnings. While revisions activity remains light, last week saw the S&P 500's Q2-2019 EPS forecast actually rise 8 cents w/w to \$40.68. That's still in line with our forecast of \$41.00, which assumes there will be yet another earnings hook during the reporting season. The consensus' \$40.68 estimate is down 1.6% since the start of the quarter, which represents a forecasted pro forma earnings gain of 0.4% y/y, compared to 0.9% a week earlier and 2.9% at the end of Q1. If it comes to pass, Q2's gain would be the 12th straight y/y rise, but down from 1.6% in Q1, 16.9% in Q4, and 28.4% in Q3 (which marked the peak of the current earnings cycle). Six of the 11 sectors are expected to record positive y/y earnings growth in Q2-2019, with only

one rising at a double-digit percentage rate. That compares to six positive during Q1, when one also rose at a double-digit percentage rate. Five sectors are expected beat the S&P 500's Q2 growth rate, the same as during Q1. However, Communication Services and Utilities are the only sectors to post better growth on a q/q basis during Q2, just as they did during Q1. Here are the latest Q2-2019 earnings growth rates versus their Q1-2019 growth rates: Communication Services (16.4% in Q2-2019 versus -9.9% in Q1-2019), Financials (6.1, 8.0), Health Care (2.8, 10.3), Utilities (2.4, -0.5), Real Estate (1.2, 6.3), Consumer Discretionary (0.2, 7.9), Industrials (-0.1, 6.9), Energy (-0.3, -26.1), Consumer Staples (-1.3, 0.9), Information Technology (-8.2, -1.1), and Materials (-27.3, -13.3). On an ex-Energy basis, S&P 500 earnings are expected to rise 0.5% y/y in Q2, down from 3.0% in Q1 and well below the 14.2% y/y gain in Q4. Q2's forecasted gain would mark the lowest ex-Energy growth rate since Q2-2016.

US ECONOMIC INDICATORS

JOLTS ([link](#)): Job openings in April fell for the second time in three months, though were only 177,000 below November's record-high reading of 7.626 million. Openings fell 25,000 in April and 176,000 over the three-month period to 7.449 million. April's ratio of unemployed workers per job opening was below 1.00 for the 14th straight month, falling to a record low of 0.78. Hirings in April jumped 240,000 to a new record high of 5.937 million, while total separations rose for the third time this year, by 70,000 m/m and 109,000 ytd to 5.578 million—within 97,000 of July's cyclical high of 5.675 million. The latest hiring and separations data yielded an employment advance of 359,000 in April, 135,000 above April's payroll gain of 224,000—overstating the increase for the fifth time in six months. Those quitting their jobs rose for the fourth time in five months, by a total of 103,000, to 3.482 million in April, only 1,000 below January's record high. April's private-industry job openings (5.0%) rate held just below its record rate of 5.2% posted in October and November, while the quit rate remained at its cyclical high of 2.6%—bouncing between 2.5% and 2.6% since mid-2018. The hires rate ticked up to 4.3%, fluctuating in a flat trend between 4.2% and 4.3% since reaching a cyclical high of 4.4% last May.

GLOBAL ECONOMIC INDICATORS

Eurozone GDP ([link](#)): Real GDP in the Eurozone accelerated 1.6% (saar) during Q1, improving steadily from Q3's 0.5%, which was the weakest since Q1-2013. Still, growth was below the 2.7%-2.8% rates recorded during the four quarters of 2017. Real consumer and business spending were the biggest contributors to Q1 growth. Real household spending (2.1%, saar) recorded its strongest quarter since Q3-2017, while real fixed capital investment (4.5) grew at a slower pace than Q4's 5.9%, though basically matched the average rate during the last three quarters of 2018. Government spending (0.3%, saar) showed little change, while inventory investment was a drag on growth. Exports (2.5%, saar) expanded at a faster pace than imports (1.7). Of the four largest economies, Spain (2.9%, saar) and Germany (1.7) exceeded the Eurozone's 1.6%, while France (1.4) and Italy (0.5) fell short.

UK GDP ([link](#)): Real GDP contracted 0.4% in April, the steepest monthly decline since March 2016, led by an easing in stockpiling, and the biggest decline in car output on record, "with uncertainty ahead of the UK's original EU departure date leading to planned shutdowns," according to the Office for National Statistics. April's decline slowed the three-month percent change to 0.3% from 0.5% during the three months through March, based on a three-month average—with Q1 growth boosted by a big stockpiling ahead of the expected March Brexit. Production industries, one of the three major industry groupings (which include manufacturing) accounted for April's sharp decline, plunging 2.7%—led by a 3.9% drop in manufacturing. Meanwhile, service industries (which account for about 80% of the private-sector economy) showed no change in April, while construction slipped 0.4%. Based on the yearly percent change, real GDP rose 1.3% y/y, with both construction (2.4% y/y) and service industries (1.7) in the plus column, while production industries contracted 1.0% y/y.

UK Industrial Production ([link](#)): Output declined for the first time this year in April, driven by the biggest decline in manufacturing production since June 2002. Headline output plunged 2.7%, more than reversing the 2.3% gain the first three months of the year, as manufacturing output plummeted 3.9%—led by a 13.4% contraction in transport equipment production. Looking at the main industrial groupings, capital goods production posted the steepest monthly decline, and the only ytd decline, while consumer goods output posted healthy ytd gains. Here's a tally: capital (-6.7% m/m & -4.6% ytd), consumer nondurable (-2.9 & 3.2), consumer durable (-0.7 & 3.4), ytd), and intermediate (-1.9 & 0.9) goods.

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