



MORNING BRIEFING

October 16, 2019

Lead Weights

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

(1) Strike and strike-out. (2) Troubles at GM & Boeing adding to US manufacturers' trade woes. (3) Manufacturing output in a growth recession. (4) Civilian aircraft shipments down 30% from March-August. (5) M-PMI showed manufacturing worsening in September. (6) Some reasons for optimism. (7) Chinese PPI is deflating again, which is bad news for profits. (8) Swine flu drives China's CPI food index up 47% y/y. (9) Not much clarity in latest Fed minutes. (10) Rate cut not a slam dunk at next FOMC meeting.

US Economy: GM & Boeing. We've been asked a few times recently whether the strike at GM and the strike-out of Boeing's 737 MAX jet are weighing on the economy. In March 2019, aviation authorities and airlines around the world grounded the Boeing 737 MAX passenger airliner after a second MAX 8 aircraft crashed, killing everyone on board. Boeing hasn't shipped any since then and may not start doing so until early next year.

GM's strike began on 9/15 with the walkout of 48,000 United Automobile Workers from some 50 plants in the US. Demands by workers include better pay, better healthcare benefits, and increased job security.

US manufacturing indicators have been weakening since early last year, suggesting that most of the sector's woes are attributable to Trump's escalating trade wars since then. Nevertheless, it's very likely that the strike and strike-out also have been weighing down manufacturing—both directly, as output from both companies has been depressed, and indirectly, as vendors to both have seen their business drop too.

Estimating the total impact of the two lead weights is hard to do, especially since GM's strike is too recent to show up in the data. Let's have a closer look at the relevant and available stats:

(1) *Industrial production.* Manufacturing output in industrial production fell 0.5% y/y during August ([Fig. 1](#)). It's down from a recent peak of 3.5% during last September. This series tends to be highly correlated with the comparable growth rate in the goods component of real GDP, which was up 4.8% y/y during Q2-2019.

On a three-month annualized basis, manufacturing output actually rose 1.2% through August ([Fig. 2](#)). That followed five consecutive negative readings for this series from March-July. So it's possible that Boeing's troubles contributed to a one-shot drop in factory production over that five-month period.

In the Fed's [industrial production](#) report, there is a category for "Aerospace and miscellaneous transportation equipment." It shows little change from March through August, slipping just 0.5% over the period ([Fig. 3](#)).

In the Fed's report, there is also a series for assemblies of autos and light trucks ([Fig. 4](#)). However, the

data is only through August.

(2) *Shipments*. Another source on manufacturing is the Census Bureau's [Monthly Advance Report on Manufacturers' Shipments, Inventories and Orders](#). It is limited to durable goods orders and shipments. It has a category for nondefense aircraft and parts shipments. It is a volatile series. It was down 30.2% y/y during August ([Fig. 5](#)). From March through August, it fell 29.7%. It's actually relatively small, currently accounting for 4% of total durable goods shipments ([Fig. 6](#)).

The report also has an item for motor vehicles and parts, which accounts for 24% of durable goods shipments. It was up 3.9% y/y through August, just before the GM strike ([Fig. 7](#)).

It's likely that Boeing's production problem with the MAX spilled over to shipments of primary metals and fabricated metal products. The former was down 6.8% y/y, while the latter was up 2.4% during August ([Fig. 8](#)). GM's strike should weigh on both up ahead, depending on how long it lasts.

(3) *Purchasing managers*. The manufacturing sector's PMI has also been weakening since late last year. It was down to 47.8 during September from a recent high of 60.8 during August 2018 ([Fig. 9](#)). This series tends to be a very good leading indicator for the growth rate of nondefense capital goods shipments excluding aircraft (which was up only 1.4% y/y during August).

The new orders component of the M-PMI was down to 47.3 during September from a recent peak of 67.3 at the end of 2017. It is a good leading indicator for the growth rate in durable goods orders (which was down 3.0% y/y during August) ([Fig. 10](#)).

In September's [M-PMI report](#), neither Boeing nor GM was mentioned as trouble spots. Instead, of the 18 manufacturing industries, only three reported growth in September.

(4) *Bottom line*. The available data through August and September suggest that US manufacturing is in a fairly widespread growth recession. The slowdown in global economic growth is probably the main cause of this soft patch, as evidenced by weak manufacturing data around the world. The recent truce in the US-China trade war could help to revive growth, as could the latest rounds of stimulus from the ECB and the Fed.

China: Inflation, Deflation & Freight. Trump's trade war has been weighing on China's economy. That's on top of homegrown problems that are depressing the nation's economic growth, specifically an increasingly geriatric demographic profile and too much debt.

The latest weak indicator was September's PPI, which was down 1.2% y/y ([Fig. 11](#)). Trump's tariffs may be forcing China's exporters to lower their prices on goods shipped to the US to stay competitive. The US import price index for China (which does not include tariffs) fell 1.8% y/y during September. China's deflating PPI spells trouble for the profitability of Chinese manufacturers.

There's more trouble for consumers evident in China's CPI, which was up 3.0% y/y during September. That's the highest consumer inflation rate since November 2013. It's been moving higher on soaring pork prices resulting from the swine flu epidemic. The CPI for meat, poultry, and related products is up 46.9% y/y ([Fig. 12](#)). The good news is that excluding food, the CPI was up only 1.0% y/y during September, the lowest pace since March 2016 ([Fig. 13](#)).

Also good news for China is that the 12-month average of railways freight traffic rose to yet another record high during August, even though the sum of exports plus imports has stalled at a record high since late last year ([Fig. 14](#)).

The Fed: Keeping the Boat Afloat. The [Minutes of the Federal Open Market Committee](#) (FOMC), released last Wednesday and covering the 9/17-18 meeting, seemed a bit more stale than usual, especially given how quickly geopolitical events are moving these days. Participants focused mostly on the reasons for the decision to cut rates another 25bps during September to a range of 1.75%-2.00%.

Not much of a sense of where rates are headed was discussed. Several participants suggested that more clarity should be provided to the markets about “when the recalibration of the level of the policy rate in response to trade uncertainty would likely come to an end.” What’s more, a “few” participants thought that financial markets’ expectations for the path of the federal funds rate “were currently suggesting greater provision of accommodation at coming meetings than they saw as appropriate.”

From what Melissa and I can gather, the Fed may have less reason and less room to cut rates again in the near term. The FOMC meets again two more times this year, on 10/29-30 and 12/10-11. Officials may be able to justify one more cut in October along with a signal that there won’t be any more cuts for now unless incoming US economic data markedly sours.

In fresh [remarks](#) last week, Fed Chair Powell said that the expansion feels “very sustainable.” He added: “Clearly things are slowing a bit,” but US economic growth “may just be gathering itself.”

Consider the following:

(1) *Geopolitics.* The Fed may have less reason to cut rates further on the basis of geopolitical uncertainties at the next meeting than they did at the previous one. Global risk factors that could impact the path of policy noted in the Minutes included trade tensions between the US and China, political tensions in Hong Kong, uncertainties related to Brexit, and escalating tensions related to the attacks on Saudi oil facilities.

Not all these hot issues have been fully resolved over the month since the meeting, but they have cooled some. The US and China seem to have reached a trade truce. Intense talks between the EU and the UK regarding a possible Brexit deal are happening now. If no deal materializes soon, then the Brexit deadline may be extended. Tensions remain in the Middle East, but at least Saudi Arabia’s full oil production capacity should be recovered soon.

But global uncertainties seem to change by the day. If they escalate again, weighing on domestic business investment and manufacturing output, the Fed might see cause to more aggressively cut rates.

(2) *Inflation.* Persistently low inflation despite historically low interest rates continues to be one of the biggest challenges for FOMC officials. However, in the Minutes, meeting participants noted a recent firming in the incoming data. To describe the low state of inflation, some participants used the word “transitory,” a word that received a lot of attention after Fed Chair Powell used it during his 5/1 [press conference](#).

From then until now, it seemed that officials had backed away from suggesting that below 2.0% target PCED inflation might be temporary. But the September meeting Minutes stated that participants agreed that inflation would move up to the Committee’s objective over the medium term under the appropriate policy.

(3) *ELB.* There really is not much room to cut rates from here. The federal funds rate is about eight 25bps rate cuts away from zero even though the US economy is in a generally stable growth

environment. The first section of the Minutes indicated a concern among members about what could be done in the event of a downturn with perpetually low inflation despite a near zero-policy rate, also referred to as the “effective lower bound” (ELB).

The Fed’s policy-setting committee discussed going to a more aggressive balance-sheet policy, allowing the balance sheet to expand, in the event of a downturn. That suggests to us that the Fed may not be so keen on turning to negative interest rates in hard times, favoring instead a return to quantitative easing (QE) to stimulate the economy, especially at the point of the ELB.

Officials also discussed using inflation “makeup” strategies, which would keep rates accommodative for longer, allowing inflation to temporarily overshoot the target. The Fed has been debating this for some time now without any signs of implementing it. Some officials see these strategies as difficult to commit to and communicate, presenting a credibility challenge. Some also see possible financial stability risks as an outcome.

(4) *SEP*. The Summary of Economic Projections (SEP) accompanying the Minutes did not provide much in the way of forward-looking clues. Projections did not change much from the June meeting except for the federal funds rate. It was lowered to 1.9% from 2.4% for 2019, reflecting the latest rate adjustment. While the projection for 2020 was lowered from 2.1%, it was held at the same rate as projected for 2019, or 1.9%, indicating no further rate moves into next year. Further out, rates are projected to increase to 2.1%, 2.4%, and 2.5% in 2021, 2022, and over the longer run, respectively.

Looking at the Fed’s dot plot, most Fed forecasters expect rates either to stay put or be hiked. We don’t know which dots belong to whom nor which represent voters on the FOMC this year. But it’s notable that of the 17 forecasting officials, five project keeping rates as is and five project a rate increase (for a total of ten that prefer not to cut) while seven project a cut by the end of the year.

CALENDARS

US. Wed: Retail Sales Total, Ex Autos, Ex Autos & Gas, Control Group 0.3%/0.2%/0.3%/0.3%, Business Inventories 0.2%, NAHB Housing Market Index, MBA Mortgage Applications, Treasury International Capital, Beige Book, Brainard, Evans. **Thurs:** Headline & Manufacturing Industrial Production -0.2%/-0.3%, Capacity Utilization 77.7%, Housing Starts & Building Permits 1.320mu/1.342mu, Jobless Claims 215k, Philadelphia Fed Manufacturing Index 7.1, DOE Crude Oil Inventories, EIA Natural Gas Storage, Williams, Evans, Bowman. (DailyFX estimates)

Global. Wed: European New Car Registrations, Eurozone Headline & Core CPI 0.9%/1.0% y/y, Eurozone Trade Balance, UK Headline & Core CPI 1.8%/1.7% y/y, Canada Headline & Core CPI 2.1%/2.2% y/y. Australia Employment Change & Unemployment Rate 15k/5.3%, Carney, Lane, Debelle. **Thurs:** UK Retail Sales Including & Excluding Fuel, 3.1%/2.9% y/y, China GDP 6.1% y/y, China Industrial Production 5.0% y/y, China Retail Sales 7.8% y/y, Japan Headline, Core, and Core-Core CPI 0.2%/0.3%/0.5% y/y, BOE Liabilities/Credit Conditions Survey, UK Sovereign Debt To Be Rated By Fitch, Lowe, Visco, Knot, DeCos. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500 Q3 Earnings Season Monitor ([link](#)): With the large financials reporting today, the Q3-2019 earnings season is beginning to get underway. Almost 7% of the S&P 500 companies have finished reporting, and their revenues and earnings are beating the consensus forecasts by 1.5% and 4.3%, respectively. Those are about the same rates as during the same point in Q2, but the percentages of companies showing a positive revenue surprise and positive y/y revenue growth are weaker. The early

story for earnings is better, though—higher percentages show a positive surprise and positive y/y growth. Of the 34 companies in the S&P 500 that have reported through mid-day Tuesday, 85% exceeded industry analysts' earnings estimates. Collectively, the early reporters have a y/y earnings decline of 0.4%, primarily due to Micron Technology's earnings deceleration. On the revenue side, 62% of companies beat their Q1 sales estimates so far, with results 3.8% higher than a year earlier. Ex-Micron, y/y earnings growth for the S&P 500 jumps to 6.9% from -0.4% and revenue growth improves to 5.0% from 3.8%. Overall Q3 earnings growth results are positive y/y for 77% of companies, and revenues have risen y/y for 82%. While these figures will change markedly as more Q3-2019 results are reported in the coming weeks, what companies say about their expectations for Q4-2019 and their early peek at 2020 prospects will be investors' main focus.

US ECONOMIC INDICATORS

Regional M-PMI ([link](#)): The New York Fed—the first district to report on manufacturing activity for October—showed activity improved this month, though remained subdued—with the outlook data following suit. The composite index edged up to 4.0 this month after easing from 4.8 to 2.0 last month, averaging 3.8 the past four months—following June's (-8.6) dip into negative territory. Shipments (to 13.0 from 5.8) grew at double the pace of September, while orders (unchanged at 3.5) held at last month's rate. The unfilled orders (-12.5 from -2.6) index was negative for the fifth consecutive month, while delivery times (-2.5 from 0.7) decreased slightly, and inventories (-0.6 from 8.5) were little changed. Employment (7.6 from 9.7) gains remain modest as the average workweek (8.3 from 1.7) continued to expand. On the inflation front, both prices-paid (23.1 from 29.4) and prices-received (6.3 from 9.2) measures increased at a slower pace than last month. The index for future business conditions (17.1 from 13.7) improved modestly, though remained well below the levels seen for much of the past few years. Indexes for future new orders (23.5 from 21.9) and shipments (18.9 from 20.4) were little changed from last month, while indexes for future prices remained fairly elevated.

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