



MORNING BRIEFING

November 5, 2019

It's an Old World After All

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

(1) Is global slowdown all Trump's fault? (2) Significant slowing in world production growth since early 2018. (3) Global PPIs and commodity prices confirming widespread slowdown. (4) Too much stuff: peak demand for gadgets, autos, and oil? (5) The global economy is aging and experiencing EDR disorder. (6) Lots of structural trends weighing on global auto sales. (7) US household employment shows boom in full-time jobs. (8) No stagnation here: Real wages up 1.0% per year on average since early 1990s! (9) More and more of capital spending is on high tech.

Global Economy I: EDR Dysfunction. Trump's escalating trade wars have been blamed for the global manufacturing recession. That makes sense since the sputtering of global industrial production began in early 2018 when Trump started his trade tiffs with almost all of America's major trading partners. If that blame is well placed, then Trump's apparent moves to de-escalate trade tensions as the November 2020 presidential election approaches should revive the global economy.

Global industrial production growth peaked at 4.1% y/y at the start of last year. It was down to 0.4% during August ([Fig. 1](#)). Production in the economies of the Organisation for Economic Co-operation and Development's 36 member countries peaked at 4.1% during December 2017 and fell to -0.4% during July. During August, industrial output was down 0.7% y/y among advanced economies (the slowest since July 2016) and up only 1.4% among emerging economies (the lowest since July 2009) ([Fig. 2](#)).

Confirming this weakness are producer price indexes (PPI) around the world, particularly in the US (-0.2% y/y through September for the finished goods PPI) and China (-1.2% y/y through September for the total industrial products PPI) ([Fig. 3](#)). The same conclusion applies to the weakness in the CRB raw industrials spot price index ([Fig. 4](#)).

Then again, could it be that the world may simply be stuffed with too much stuff? More specifically, the world may be experiencing peaks in the demand for autos, consumer electronics, and oil. These developments may be structural rather than cyclical. We attribute these peaks to the ongoing decline in the global elderly dependency ratio (EDR), i.e., the working-age population divided by the elderly population 65 years old or older.

Yes, the world may be suffering from EDR dysfunction! Unfortunately, there are no blue pills that can cure this disorder.

EDRs are falling around the world because fertility rates are falling below the replacement rate of 2.1 children per woman as a result of urbanization. Kids have an economic value in rural agrarian communities but represent all cost in urban settings. In addition, people are living longer beyond their retirement, increasing the tax burden on the working-age population that isn't being replenished sufficiently. That all adds up to slower consumer spending on lots of stuff, resulting in excess capacity to produce said stuff. Excessive amounts of debt are financing the excess capacity, resulting in

deflationary forces that have been offset, but not vanquished, by the ultra-easy monetary policies of the major central banks.

Older folks tend to be more frugal than younger ones because they don't know how long they will live. So they have to ration whatever income and assets they have. The result is peak gadgets. Older folks are less likely to own a car, and if they do own one, they aren't likely to drive very far from their homes. The result is peak autos and peak oil. These days, younger folks tend to be minimalists for various reasons.

Let's have a closer look at EDRs around the world:

(1) *Fertility*. According to data compiled by the United Nations (UN), the global fertility rate has dropped from 5.0 children per woman during 1955 to 2.5 during 2019 ([Fig. 5](#)). It is actually below the 2.1 replacement rate almost everywhere with the exception of Africa and India. Here are the 2019 fertility rates for selected regions and countries: Japan (1.4), Europe (1.6), China (1.7), US (1.8), Latin America (2.1), Asia (2.2), India (2.3), and Africa (4.5). (See our [Global Fertility Rates](#).)

(2) *World EDRs*. The UN estimates that the EDR for the world fell from 11.8 during 1955 to 10.1 during 1985 to 7.2 during 2019 ([Fig. 6](#)). Over the past 30 years, the EDR for developed economies is down from 5.4 to 3.4 ([Fig. 7](#)). The EDR for emerging economies is down from 13.5 to 9.1 over this same period ([Fig. 8](#)).

(3) *Country EDRs*. Here are the 2019 EDRs for Japan (2.1), Europe (3.5), the US (4.0), China (6.2), Latin America (7.7), India (10.5), and Africa (16.1). They are all down significantly since the 1950s. We reckon that they weigh on growth once the number of workers per senior falls below 4.0. (See our [Global Elderly Dependency Ratios](#) chart book.)

Global Economy II: Peak Autos. Jackie and I started writing about peak autos in our 4/11 [Morning Briefing](#). We identified several developments suggesting that there isn't much, if any, upside to global sales of passenger motor vehicles. We also started to surmise that the global manufacturing recession may be partly attributable to the structural weakness in car sales. Here are a few of our updated thoughts on this important subject:

(1) *Ridesharing is a big negative for car sales*. An HSBC survey found that 18% of frequent Uber and Lyft users say they are less likely to buy or lease a car in the future, a 1/23 [Barron's article](#) reported. These killer apps and increasing urbanization led Bloomberg *Businessweek* to question in a 2/28 [article](#) whether the world has reached "peak car." The tipping point, the article contends, will occur around 2030 when automated cars hit the road, cutting 60% from the cost of taking a taxi and making car-sharing much cheaper than owning a car.

(2) *Fewer teens getting driver's licenses*. According to the Bloomberg story: "Young people continue to turn away from cars, with only 26 percent of U.S. 16-year-olds earning a driver's license in 2017, a rite of passage that almost half that cohort would have obtained just 36 years ago, according to Sivak Applied Research. Likewise, the annual number of 17-year-olds taking driving tests in the U.K. has fallen 28 percent in the past decade."

(3) *Depressing global manufacturing and trade*. A 10/29 [WSJ article](#) by Greg Ip is titled "'Peak Car' Is Holding Back the Global Economy." He observed: "Given the industry's outsize influence, an enfeebled auto industry poses a little-realized risk to the world. In its latest *World Economic Outlook*, the International Monetary Fund estimates the sector accounts for 5.7% of global economic output and 8% of world trade. The IMF thinks autos contributed a fifth of last year's slowing in global gross domestic

product and a third of the slowdown in trade.”

(4) *A green bad deal for autos.* Regulators in Western Europe are imposing significant emission control standards that will increase the cost of cars. If the auto makers raise their prices to cover their costs, more would-be buyers will opt for ridesharing apps. India is also mandating tougher pollution standards.

(5) *Sales are stalling and sputtering.* China is the biggest auto market in the world. The 12-month sum of auto sales peaked at a record 29.6 million during June 2018 ([Fig. 9](#)). It was down 12.2% to 26.0 million during September.

New passenger car registrations in Europe peaked at 15.8 million units over the 12 months through August 2018. They were down 5.1% to 15.0 million through September. US motor vehicle sales have been stalled around 17.0 million (on a 12-month-run basis) since December 2017.

US Economy I: Consumers Are ‘in a Good Place.’ As we noted in yesterday’s [Morning Briefing](#), Fed Chair Jerome Powell observed in his press conference last Wednesday that “the household sector’s in a very good place.” His upbeat assessment certainly was confirmed by Friday’s employment report. Consider the following happy developments:

(1) *Earned income proxy flying high.* As Debbie observed yesterday, our Earned Income Proxy for private-sector wages and salaries rose 0.3% m/m and 4.3% y/y during October. Average hourly earnings (AHE) for all workers rose 3.0% y/y, while aggregate weekly hours rose 1.3% y/y. These are all solid readings.

(2) *Full-time employment soaring.* Although 50,000 GM workers were on strike last month, durable goods manufacturing employment declined less than that, by 41,000. Total payrolls rose 128,000. October jobs growth would likely have been closer to 200,000 if not for the strike and the end of temporary Census jobs last month. The strike ended late last month, so November’s payroll employment will be boosted by returning GM workers.

Meanwhile, September’s increase was revised upward from 136,000 initially to 180,000, and the August gain was revised higher from 168,000 to 219,000. We pay more attention to the revisions of the previous two months than to the initial estimate for the current month, as we’ve often mentioned.

The payroll survey counts the number of jobs, while the household survey counts the number of workers regardless of whether they have one job or more. The latter showed a gain of 241,000 during October. The number of those workers with full-time jobs rose 451,000 last month to a record 131.5 million, or 83% of total household employment ([Fig. 10](#)).

(3) *Wages outpacing price inflation.* The widespread belief that real wages have been stagnating for decades is absurd and dead wrong. As we observed yesterday, they did decline during the 1970s as a result of the two oil price shocks and during the 1980s as a result of deindustrialization. However, they’ve been on a solid uptrend since 1995. That’s based on AHE for production and nonsupervisory workers, who account for 70% of payroll employment currently.

Another measure of real wages is the wage and salary component of the Employment Cost Index for private-sector workers divided by the personal consumption expenditures deflator ([Fig. 11](#)). It’s been trending higher since 1991. It’s up 28.5% (1.0% per year, on average) since then to a new record high.

US Economy II: What’s in Capital Spending? There is a widespread view that capital spending is weak. Yesterday, we observed that the recent weakness isn’t widespread but concentrated in

structures and transportation equipment. On the other hand, spending on industrial equipment rose to a record high during Q3. Furthermore, spending on information processing equipment, software, and R&D remains very strong and accounts for an increasing share of nominal capital spending budgets.

I started writing about the High-Tech Revolution in 1993 and have been following the GDP stats on high-tech capital spending since then. During 1993, capital spending on IT equipment, software, and R&D totaled 39% of capital spending in nominal GDP ([Fig. 12](#)). It was up from 15% during 1959. It is now up to 47% of nominal GDP. Excluding R&D, spending on IT equipment and software is up from only 7% in 1959 to 29% of capital spending in nominal GDP currently.

CALENDARS

US. Tues: Job Openings 7.075m, Trade Balance -\$52.5b, ISM NM-PMI 51.1, Kashkari, Kaplan. **Wed:** Nonfarm Productivity & Unit Labor Costs 0.9%/2.2%, MBA Mortgage Applications, DOE Oil Inventories, Williams, Evans, Harker. (DailyFX estimates)

Global. Tues: UK C-PMI & NM-PMI 49.4/49.7, BOJ Minutes of September Meeting. **Wed:** Eurozone Retail Sales 0.1% m/m/2.4% y/y, Eurozone, Germany, France, and Italy C-PMIs 50.2/48.6/52.6/50.2, Eurozone, Germany, France, and Italy NM-PMIs 51.8/51.2/52.9/51.0, Germany Factory Orders 0.1% m/m/-6.3% y/y, Guindos. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings edged lower for two of these three indexes last week. These indexes began a forward-earnings uptrend during March, but only LargeCap is near a record high. LargeCap's forward earnings has risen during 28 of the past 38 weeks, MidCap's 19 of the past 34 weeks, and SmallCap's 17 of the past 32 weeks. LargeCap's is just 0.2% below its record high seven weeks ago, while MidCap's and SmallCap's are 4.5% and 8.2% below their October 2018 highs. MidCap's forward earnings is near a 14-month low now, while SmallCap's forward earnings is near a 15-month low because analysts are now including a large goodwill writeoff in their 2019 annual forecast for Frontier Communications. At their bottoms earlier in 2019, LargeCap's forward EPS had been the most below its record high since June 2016 and MidCap's was the lowest since May 2015. During mid-September, 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 began to tumble in October as y/y comparisons became more difficult. In the latest week, the rate of change in LargeCap's forward earnings dropped to a 38-month low of 1.0% y/y from 1.1%. That's down from 23.2% in September 2018, which was the highest since January 2011. MidCap's -4.1% y/y change is the lowest since December 2009 and down from -3.6% a week ago. That compares to 24.1% in September 2018 (the highest since April 2011). SmallCap's -7.6% y/y change is up from -9.6% in mid-September, which was the lowest since December 2009 and compares to an eight-year high of 35.3% in October 2018. 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%, 0.5%, 10.5%), MidCap (22.7, -5.4, 12.3), and SmallCap (22.4, -16.8, 36.8).

S&P 500/400/600 Valuation ([link](#)): Valuations rose last week for all three of these S&P market-cap indexes, and continue to improve from their three-month lows during the late summer. LargeCap's forward P/E rose 0.3pt w/w to a 21-month high of 17.3. That compares to a five-year low of 13.9 during December and 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 was up 0.3pt w/w, to a 14-month high of 16.6, and is

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 rose 0.2pt w/w to a six-week high of 17.4, but remains below the 12-month high of 17.8 in mid-September. That's still well above its seven-year low of 13.6 during December and compares to its 15-year high of 20.5 in December 2016, when Energy's earnings were depressed. SmallCap's P/E was above LargeCap's again for a third week, primarily due to substantially lower forward earnings for Frontier Communications. It had been below for four months through the end of August—the first time that has happened since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q3 books closed and earnings reports still pouring in, Q3's blended estimate/actual improved for a third straight week. The S&P 500's Q3-2019 EPS forecast surged 63 cents w/w to \$41.95. That represents an earnings decline of 1.7% y/y compared to the prior week's forecasted earnings drop of 3.1%. While the consensus Q3 EPS estimate is below our forecasts of \$43.00 and slightly positive y/y earnings growth of 0.8%, it's now above the \$41.31 reported for Q2. On a pro forma basis, Q3 earnings are expected to decline 0.8% y/y, which would be the first drop in 13 quarters and compares to y/y gains of 3.2% in Q2, 1.6% in Q1, 16.9% in Q4-2018, and 28.4% in Q3-2018 (which marked the peak of the current earnings cycle). Seven of the 11 sectors are expected to record positive y/y earnings growth in Q3-2019, with none rising at a double-digit percentage rate. That compares to seven positive during Q2, when three rose at a double-digit percentage rate. The same seven sectors are expected to beat the S&P 500's Q3 growth rate, up sharply from just three beating the S&P 500 during Q2. Consumer Staples, Industrials, Materials, Real Estate, and Utilities are the only sectors expected to post better (or less worse) growth on a q/q basis during Q3. On an ex-Energy basis, the consensus expects earnings to rise 1.6% y/y in Q3. That compares to ex-Energy gains of 3.9% in Q2 and 3.0% in Q1, and is well below the 14.2% y/y gain in Q4-2018. Here are the latest blended Q3-2019 earnings growth rates versus their Q2-2019 growth rates: Health Care (8.8% in Q3-2019 versus 10.3% in Q2-2019), Utilities (5.8, 1.1), Real Estate (5.5, 3.1), Consumer Staples (3.2, 1.7), Industrials (3.0, -9.5), Financials (1.6, 10.0), Consumer Discretionary (1.2, 2.7), Communication Services (-2.5, 17.6), Information Technology (-2.7, -2.2), Materials (-10.2, -12.7), and Energy (-35.5, -8.9).

S&P 500 Q3 Earnings Season Monitor ([link](#)): With the Q3-2019 earnings reporting season over 71% complete, S&P 500 revenues and earnings are beating the consensus forecasts by 0.9% and 4.9%, respectively. At the same point during the previous earnings season for Q2, revenues and earnings had beaten forecasts by a higher 1.5% and 6.4%, respectively. However, a higher percentage of companies has recorded a positive earnings surprise in Q3 than in Q2—77% versus 74%. A similar percentage of companies showed a positive revenue surprise—59% versus 59%. The 359 companies in the S&P 500 that have reported through mid-day Monday collectively have recorded a y/y earnings gain of 0.3%, dragged down by Micron Technology's earnings deceleration. On the revenue side, results are 2.7% higher than a year earlier. Ex-Micron, y/y earnings growth for the S&P 500 jumps 1.2ppts to 1.5% and revenue growth improves 0.2ppt to 2.9%. Adjusting for the dismal y/y growth declines for the Energy sector, Q3's S&P 500 ex-Energy revenue growth improves 1.4ppt to 4.1% and earnings growth rises 2.2ppts to 2.5%. Overall, Q3 earnings growth results are positive y/y for 65% of companies versus a tad higher 66% at the same point in Q2, and revenues have risen y/y for 71% compared to a lower 68% in Q2. These figures will continue to change as more Q3-2019 results are reported in the coming weeks. However, y/y earnings growth is likely to trail revenue growth for a third straight quarter, something that hasn't happened since the last Energy "recession" in H1-2016. Regardless, what companies say about their expectations for Q4-2019 and their early peek at 2020 prospects will be investors' main focus.

US ECONOMIC INDICATORS

Construction Spending ([link](#)): Construction expenditures in September beat expectations as homebuilding climbed to a nine-month high. Overall spending advanced by 0.5% in September after a downward revision to August (to -0.3% from 0.1%) and an upward one to July (0.5% from 0.0%). Private construction spending has barely budged in recent months, while public construction spending is in a volatile flat trend around record highs. Within private construction spending, single-family construction rose for the third straight month, by a total of 3.9%, after falling in 12 of the prior 13 months by 10.9% altogether. Meanwhile, multi-family investment contracted 3.3% during the four months through September, while home-improvement spending has been moving sideways so far this year. Private nonresidential construction spending sank 2.0% during the three months through September and is flat ytd. Public construction spending rose for the second time in three months by 1.8%—and the sixth time this year, for a ytd gain of 10.0%.

Manufacturing Orders & Shipments ([link](#)): Overall manufacturing orders lack momentum, facing headwinds from weak global demand and the prolonged US-China trade war. This past weekend, however, US Commerce Secretary Wilbur Ross said he was “quite optimistic” that the remaining hurdles in phase one of the negotiations with China could soon be overcome. Total factory orders in September fell for the fifth time this year, by 0.6% m/m, and is 3.5% below its recent peak a year ago. Orders for industrial machinery have been showing signs of life recently, increasing for the fourth consecutive month, by a whopping 15.3%. Meanwhile, orders for computers & electronic have been heading lower, down 2.9% during the four months through September. Core capital goods orders and shipments in September have remained near record levels, though have headed south in recent months. Nondefense capital goods orders ex aircraft (a proxy for future business investment) fell 1.4% during the two months through September after rising 2.2% the first seven months of this year. Core capital goods shipments (used in calculating GDP) haven’t posted a gain in five months, down 1.5% during the four months through September after a string of gains earlier this year.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs ([link](#)): Global manufacturing activity in October contracted for the sixth consecutive month, though moved closer to stabilization, increasing for the third month to a five-month high. JP Morgan’s M-PMI (to 49.8 from 49.7) ticked up slightly in October for the third month, from July’s 49.3—which was the weakest reading since October 2012. It was at a seven-year high of 54.4 at the end of 2017. The emerging nations M-PMI remained at 51.0 last month after climbing steadily from 49.9 in June; it was at 49.5 in January—which was the first reading below 50.0 since mid-2016. Meanwhile, the M-PMI for developed nations was unchanged at 48.6, its sixth month in contractionary territory, after recovering to 50.2 in April following a brief dip below 50.0 in March (to 49.9). M-PMI readings signaled expansion in 13 out of the 32 countries for which October data are available, including Greece (53.5 from 53.6), Brazil (52.2 from 53.4), China (to 51.7 from 51.4), the US (51.3 from 51.1), France (50.7 from 50.1), Ireland (50.7 from 48.7), and the Netherlands (50.3 from 51.6)—with Ireland moving from contraction to expansion, and China, the US, and France improving slightly from their September levels. The European nations on the whole fared poorly last month, with Germany (42.1 from 41.7), Austria (45.5 from 45.1), Spain (46.8 from 47.7), and Italy (47.7 from 47.8) among the bottom eight, along with the Czech Republic (45.0 from 44.9), Russia (47.2 from 46.3), and the Eurozone (45.9 from 45.7) average.

US Manufacturing PMIs ([link](#)): Manufacturing activity in October contracted at a slower pace, according to the ISM survey—though ISM notes last month’s reading is consistent with roughly a 1.6% annualized increase in real GDP, based on the past relationship of the two measures. Meanwhile, IHS Markit’s measure showed a slight acceleration for the second month, growing at its fastest pace in six

months. ISM's composite (to 48.3 from 47.8) index edged up after sinking to its lowest reading since June 2009 in September. Last month, manufacturers saw new orders (49.1 from 47.3) and production (46.2 from 47.3) continue to decline, though the former moved up closer to the breakeven point of 50.0, while the latter contracted at its fastest rate since April 2009. Factory employment (47.7 from 46.3) was in contractionary territory for the third month, down from a high for this year of 57.5 in March. The remaining two index components showed that supplier deliveries (49.5 from 51.1) dipped below 50.0 for the first time since February 2016, while inventories (48.9 from 46.9) contracted at a slower pace after posting its worst performance since December 2016 in September. Worth noting, while all the components of ISM's M-PMI were below 50.0 in October, the new export orders (50.4 from 41.0) sub-index jumped back above 50.0—after three months below. Prices contracted at a faster rate compared to September, falling 4.2ppts to 45.5—near July's 41-month low of 51.1; the index peaked at 79.5 in May 2018. IHS Markit's M-PMI improved for the second month to 51.3, from 51.1 in September and 50.3 in August, suggesting "the soft patch bottomed out in July," according to the report. The overall rate of growth remained well below the long-run series average, though improvement in current conditions was matched by a lifting of business optimism about the year ahead to the highest seen since June. Still, survey respondents continued to report widespread concerns about tariffs, the auto sector's ongoing weakness, a lack of pricing power amid soft demand, and uncertainty about the economic and political situation over the coming year.

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