MORNING BRIEFING
December 16, 2019

Peace in Our Time

See the pdf and the collection of the individual charts linked below.

(1) Anti-war slogan. (2) Phasing in a trade deal with China. (3) Manufacturing may be weighed down by too much capacity and aging consumers. (4) No global boom in 2020. (5) The zombie story again. (6) Commodity prices may be signaling better growth ahead. (7) Mixed bag of US economic indicators still adding up to 2% growth. (8) Germany's auto industry dragging down European manufacturing. (9) The Year of the Pig has been bad for pigs, and Chinese consumers. (10) Real retail sales growth in China remains on downtrend. (11) Children of one-child nation facing big burden as young adults tending to their aging parents' needs.

Global Economy I: Peace Dividend? "Suppose They Gave a War and No One Came" was the title of a 1966 *McCall's* magazine article by Charlotte E. Keyes. She helped to popularize the American antiwar slogan from the hippie subculture during the Vietnam War era.

Now suppose that Trump's trade wars end; will the global economy get a boost from the resulting peace dividend?

We might get an answer in 2020 now that the US and China have agreed on a Phase 1 trade deal. Of course, the trade war between the two countries isn't over, but it has been significantly deescalated. There is at least one more phase to negotiate, if not many more.

While Trump agreed to postpone the 12/15 round of tariffs on imports from China, plenty of others, imposed over the past two years, are still in place. Furthermore, he might be emboldened by his apparent success in using tariffs as an economic weapon to attack unfair European trade practices. He might even escalate the trade war with the Chinese next year to secure a better Phase 2 deal than possible unless he gets tougher with them.

Debbie and I expect that the global economy will benefit if Trump deescalates his trade wars next year as he focuses on winning the November 2020 presidential election for a second term. However, global economic growth might disappoint if it turns out that something more than just Trump's trade wars has been slowing the global economy since early 2018, especially in the manufacturing sector.

Specifically, manufacturers around the world may be hamstrung by operating in a global economy that is stuffed with too much stuff. That's because ultra-easy credit conditions over the past 10-plus years have financed lots of capacity expansion, particularly by zombie factories that would be shut down but for the availability of easy credit. At the same time, geriatric demographic profiles are getting more geriatric around the world, as people aren't having enough kids to replace themselves and are living longer.

As a result, we expect somewhat better global economic growth next year, but no boom. That's a good thing given our mantra: "No boom, no bust." A related concept of ours: "No credit crunch, no recession." As we observed in our 12/11*Morning Briefing* titled "More Easy Money in 2020," the total assets of the world's three major central banks is on track to make new record highs next year.

So credit conditions should remain easy. The problem is that easy money allows the zombie companies to multiply, exacerbating excess capacity in manufacturing and resulting in deflation for goods prices. We discussed this development in our 11/13 *Morning Briefing* titled "Zombies In the Fed's Soup." Here was the crux of our argument:

"Meanwhile, supply-side borrowers, who produce the goods and services purchased by demand-side borrowers, can take advantage of easy money to refinance their debts at lower rates. Producers may also borrow more to keep their businesses going. The ones who are most likely to do so are the ones who would be out of business if they couldn't borrow money. In other words, they are zombie businesses, i.e., the living-dead companies that won't die because they are resuscitated by the cash infusions provided by their lenders. As long as they stay alive, they create deflationary pressures by producing more goods and services than the market needs.

"And why are lenders willing to lend to the zombies? Instead of stimulating demand, historically low interest rates incite a reach-for-yield frenzy among lenders. They are willing to accept more credit risk for the higher returns offered by the zombies. Besides, if enough zombies fail, then surely the central banks will come up with some sort of rescue plan."

In any event, it was good to see that commodity prices rose sharply on Thursday and Friday in reaction to the announced US-China trade deal. The CRB raw industrials spot price index is showing signs of bottoming (*Fig. 1*). The same can be said of its copper price component (*Fig. 2*). The price of crude oil also firmed up last week (*Fig. 3*).

Global Economy II: More of the Same. While last week's bullish reaction in the commodity pits to the trade news is a happy development, other recent global economic indicators continued to show US growth remaining slow and steady, European growth still weakening, and Chinese growth continuing to slow. Consider the following:

(1) *US economy moseying along*. Notwithstanding November's weaker-than-expected retail sales reported on Friday, the Atlanta Fed's *GDPNow* estimate for Q4 GDP growth remained at 2.0%, the same as it was on 12/6. According to the GDPNow website, the "increases in the nowcasts of fourth-quarter real government spending growth, real private inventory investment, and real net exports were offset by a decline in the nowcast of fourth-quarter real personal consumption expenditures growth."

In current dollars, the monthly series on total federal government spending excluding the major entitlement programs (which redistribute income) closely tracks federal government outlays on goods and services in nominal GDP (*Fig. 4*). The former was up 8.6% y/y through November to a new record high of $1.68 trillion, while the latter was up 5.4% y/y through Q3.

There was a small uptick of 0.2% m/m in current-dollar business inventories during October (*Fig. 5*). Nevertheless, the series has stalled out at a record high around $2.0 trillion since the start of this year. The real merchandise trade deficit did narrow in October, which should boost real GDP (*Fig. 6*).

Current-dollar retail sales rose 3.1% y/y during November, but the available October data show that manufacturing shipments were down 1.5% y/y and wholesale sales were down 1.4% y/y (*Fig. 7*).

(2) *European production struggling.* Is it possible that young adults around the world don't aspire to own a Benz or a Bimmer, even if they could afford to do so? That's hard for Baby Boomers to wrap their minds around, we know!

But that might explain some of the weakness in German auto production. Many young people today don't aspire to own any car at all. They prefer ride-sharing services and scooters. Many also worry about climate-change issues and may be waiting for electric vehicles to become a practical alternative to gasoline-powered cars.

Compounding the woes of European automakers were stringent emission-control standards imposed during September 2018. The result is that German auto production, based on the 12-month sum, plunged 14% since then through November of this year (*Fig. 8*).

German manufacturing output is down 6.1% y/y through October (*Fig. 9*). That has weighed on the Eurozone manufacturing index, which is down 2.3% over the same period.

(3) *China running out of pigs and shoppers.* The swine flu is devastating China's supply of pigs. That's ironic given that 2019 is the Year of the Pig according to the Chinese Zodiac.

The CPI for meat, poultry & related products jumped 74.5% y/y through November (*Fig. 10*). The overall CPI rose 4.5% over this period, but only 1.0% excluding food (*Fig. 11*).

The y/y growth rate in inflation-adjusted retail sales dropped to 3.4% during October, the lowest reading since December 1997 (*Fig. 12*).

Pork is a significant portion of the budgets of lots of low-income Chinese families. So it's not surprising that the growth rate of retail sales has been falling sharply recently. However, real retail sales growth has been on a significant downward trend since late 2009.

We believe that the combination of urbanization and the one-child policy from 1979 to 2015 is weighing heavily on Chinese consumers. Just think about all those young adults who are the only children of their two elderly parents. In China, children have a social responsibility to take care of their aging parents. That's a heavy burden. Now imagine the burden of a married couple composed of two only children: They have four older parents to support.

China's fertility rate has been falling since the mid-1950s in part because of urbanization (*Fig. 13*). The one-child policy pushed the fertility rate below the replacement rate of 2.1 children per woman during 1994. The UN projects that it will remain below the replacement rate through the end of the current century.

CALENDARS

US. Mon: M-PMI & NM-PMI Flash Estimates 52.6/52.0, Empire State Manufacturing Index 4.0), NAHB Housing Market Index 70. **Tues:** Headline & Manufacturing Industrial Production 0.8%/0.8%, Capacity Utilization 77.4%, Housing Starts & Building Permits 1.340mu/1.405mu, Job Openings 7.018m, Williams, Rosengren, Kaplan. (DailyFX estimates)

Global. Mon: Eurozone, Germany, and France C-PMI Flash Estimates 50.7/49.9/52.0, Eurozone, Germany, and France M-PMI Flash Estimates 47.3/44.6/51.5, Eurozone, German, and France NM-PMI Flash Estimates 52.0/52.0/52.1, UK C-PMI, M-PMI & NM-PMI Flash Estimates 49.549.249.5, BOE Publishes Finance Stability Report, Stress Tests, RBA Minutes December Meeting, Guindos, Lane. **Tues:** Eurozone Trade Balance, Eurozone Car Registrations, UK Employment Change & Unemployment Rate (3-month) -24k/3.9%, Carney, Lane. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): Last week saw the US MSCI index rise 0.7%—its ninth gain in 10 weeks—and end the week at a record high for the first time since 11/27. The AC World ex-US outperformed with a gain of 2.2% for the week and exited the correction that has been in place since 8/2/18. However, it remains 9.2% below its record high, hit in January 2018. The US MSCI's weekly performance ranked 41st among the 49 global stock markets, of which 45 rose in US dollar terms. All of the MSCI indexes rose last week, but the following outperformed the AC World ex-US: EM Latin America (3.8%), EM Asia (3.8), EM Eastern Europe (3.4), and BRIC (3.2). The following regions underperformed: EMU (1.6), EAFE (1.7), and EMEA (2.1). Korea was the best-performing country, with a gain of 6.8%, followed by Mexico (6.7), Hungary (5.5), Chile (5.3), and Taiwan (4.7). Of the 30 countries that underperformed the AC World ex-US MSCI last week, Sri Lanka fared the worst—dropping 3.1%—followed by Egypt (-0.5), Jordan (-0.1), and Belgium (0.0). The US MSCI's ytd ranking dropped two places to 8/49, with its 26.6% ytd gain weakening to 10.2ppts ahead of the AC World ex-US's (16.4). All regions and 41/49 countries are in positive territory ytd. The regions that are outperforming the AC World ex-US ytd: EM Eastern Europe (23.9), EMU (18.6), EAFE (17.2), and BRIC (16.5). EM Latin America (10.6) and EMEA (10.6) are the biggest laggards ytd, followed by EM Asia (14.1). The best country performers ytd: Russia (37.9), Greece (36.0), Ireland (34.1), New Zealand (30.5), and Taiwan (30.5). The worst-performing countries so far in 2019: Argentina (-28.7), Chile (-16.3), Poland (-11.0), Malaysia (-7.5), and Jordan (-6.8).

S&P 1500/500/400/600 Performance (*link*): Over the past 10 weeks, the LargeCap and MidCap indexes have risen nine times and SmallCap was up eight times. LargeCap's 0.7% gain last week was ahead of the increases for MidCap (0.1%) and SmallCap (0.1). LargeCap ended the week at a record high of 3168.80, and MidCap is just 1.2% below its record high on 8/29/18. SmallCap has been mostly out of a 13-month correction since 11/25, but remained 8.7% below its 8/29/18 record. Twenty of the 33 sectors moved higher last week, compared to 25 rising a week earlier. Last week's best performers: MidCap Energy (4.2), SmallCap Energy (3.5), LargeCap Tech (2.0), SmallCap Tech (1.6), and MidCap Tech (1.6). SmallCap Real Estate (-3.6) was the biggest underperformer, followed by MidCap Real Estate (-3.1), MidCap Consumer Staples (-2.8), and LargeCap Real Estate (-2.6). In terms of 2019's ytd performance, all three indexes have logged double-digit gains, and both LargeCap and MidCap are on track for their best performance since 2013. LargeCap leads with a gain of 26.4% ytd, 4.7ppts ahead of MidCap (21.7) and 7.7ppts ahead of SmallCap (18.7). Thirty of the 33 sectors are positive ytd, with Tech sweeping the top performers: LargeCap Tech (44.0), MidCap Tech (38.5), SmallCap Tech (36.3), MidCap Industrials (31.3), LargeCap Communication Services (28.5), and LargeCap Financials (28.2). MidCap Energy (-23.9) is the biggest decliner so far in 2019, followed by these underperformers: SmallCap Energy (-23.4), SmallCap Communication Services (-1.8), and LargeCap Energy (4.1).

S&P 500 Sectors and Industries Performance (*link*): Nine of the 11 S&P 500 sectors rose last week as five outperformed or matched the S&P 500's 0.7% gain (versus six rising and six outperforming or matching the S&P 500's 0.2% rise the week before). Tech was the best-performing sector with a gain of 2.0%, ahead of Consumer Discretionary (1.1%), Financials (1.0), Energy (0.8), and Industrials (0.7). Last week's underperformers: Real Estate (-2.6), Communication Services (-0.7), Utilities (0.1), Consumer Staples (0.2), Health Care (0.4), and Materials (0.6). All 11 sectors are up so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. Just four sectors are still ahead of the S&P 500's 26.4% rise: Information Technology (44.0), Communication Services (28.5), Financials (28.2), and Industrials (26.6). The ytd laggards: Energy (4.1), Health Care (16.2), Utilities (19.0), Materials (19.2), Real Estate (20.5), Consumer Staples (22.9), and Consumer Discretionary (23.3).

Commodities Performance (*link*): Last week, the S&P GSCI index rose 1.3% as 22 of the 24 commodities moved higher, the highest count since the week of 1/26/18. That compares to a 3.3% gain a week earlier when 12 of the 24 commodities moved higher. The index had nearly climbed out of a correction during mid-April, recovering to a drop of just 10.0% shy of its high in early October 2018, after being down as much as 26.9% from that high on 12/24/18. It remained close to a bear market in the latest week but improved to 14.8% below its 10/3/18 high. Nickel was the strongest performer last week, rising 5.3%, ahead of Coffee (4.9%), Feeder Cattle (3.3), Soybeans (3.3), and Lean Hogs (2.9). Natural Gas was the biggest underperformer, with a drop of 2.1%, followed by Cocoa (-1.3), Brent Crude (0.1), Aluminum (0.5), and Zinc (0.6). The S&P GSCI commodities index is up 14.4% ytd following a decline of 12.0% in 2018. The top-performing commodities so far in 2019: Nickel (33.0), Crude Oil (32.1), Coffee (28.5), Unleaded Gasoline (28.0), and Brent Crude (19.4). The biggest laggards in 2019: Natural Gas (-22.4), Kansas Wheat (-9.4), Zinc (-8.9), Cotton (-7.5), and Lead (-5.6).

S&P 500 Technical Indicators (*link*): The S&P 500 price index rose 0.7% last week, and improved slightly 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 rose for an eighth week following nine straight declines. It's down from a 17-month high of 5.4% in mid-August, but has formed a Golden Cross for 38 weeks after 16 weeks in a Death Cross formation. The index had been in a Golden Cross for 137 weeks through November 2018, 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 Golden Cross reading improved to a 12-week high of 4.0% from 3.6%. That compares to a 26-week low of 2.5% in mid-October and -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 a tenth week following three down weeks, as the price index edged up to 3.3% above its rising 50-dma, but remains below its 18-week high of 3.6% above its rising 50-dma at the end of November. It had peaked recently during mid-July at a 19-week high of 4.3% above. That was up from a 22-week low of 4.2% below its falling 50-dma at the end of May, but down from 6.6% above during mid-February, which was its highest since October 2011. The 200-dma rose for a 27th week. It had been rising for 16 weeks through mid-May after falling from October to February in the first downtrend since May 2016 (when it had been slowly declining for nine months). The index traded above its 200-dma for a 28th week, and improved to a 20-week high of 7.4% above its rising 200-dma from 7.0% above its rising 200-dma a week earlier. That compares to a 17-month high of 8.8% above its 200-dma at the end of July and 14.5% below on 12/24, which was the lowest since April 2009; the index 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*): Nine of the 11 S&P 500 sectors traded above their 50-dmas last week, unchanged from a week earlier and down from all 11 the last week in October. Energy was above its 50-dma for a second week in another effort to break out of its long downtrend. Utilities remained below for a sixth week for the first time since the beginning of June, and Real Estate was below for a seventh week and just the ninth time in 48 weeks. The longer-term picture—i.e., relative to 200-dmas—weakened to nine sectors trading above from 10 a week earlier. That's up from just six at the end of August, which was the lowest count since early June. Real Estate fell below for the first time in 48 weeks. Energy was below for a 22nd week after being above—just for a week in early July—for the first time since October 2018. Ten sectors are in the Golden Cross club (with 50-dmas higher than 200-dmas), unchanged from a week earlier. That compares to just two sectors in the club during February and all 11 in January 2018. Energy has not been in a Golden Cross for 57 straight weeks. Nine sectors have rising 50-dmas now, up from eight a week earlier and down from all 11 in early November. Still, that's up from just three in early October. Energy's 50-dma turned up w/w but has been mostly falling since early May. Utilities' 50-dma fell for just the fourth time since June, and Real Estate's 50-dma fell for a sixth week and for the first time since January. Ten sectors have rising 200-dmas, unchanged from a week ago. The sole laggard, Energy, has been mostly falling since October 2018. Materials and Financials moved higher for a 16th week in their successful attempts at new uptrends for the first time since September 2018. That 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

Retail Sales (*link*): Both headline and core retail sales continued to climb in November, increasing for the ninth time this year, to new record highs; real sales, however, have stalled in recent months. Total sales advanced 0.2% in November and 5.6% ytd, while core sales—which excludes autos, gasoline, building materials, and food services—rose 0.1% and 6.6% over the comparable periods. We estimate both real retail sales and core retail sales were flat for the third straight month, after a string of solid readings. (BEA uses the core retail sales measure to estimate personal consumption expenditures each month.) Real retail sales expanded 2.5% (saar) during the three months through November, based on the three-month average, slowing from its recent peak of 5.7% during August and September. Real core retail sales grew only 1.5% (saar) over the comparable period, less than one-quarter August's 7.0% pace. In November, seven of the 13 categories rose and five fell, while building materials retailers recorded flat sales. The biggest gain was recorded by nonstore retailers (0.8%), followed by gasoline (0.7), electronic store (0.7), and motor vehicle (0.5) establishments. Sales at health & personal care stores (-1.1) led declines, followed by clothing (-0.6), sporting goods (-0.5), miscellaneous store (-0.4), and food service & drinking (-0.3) retailers.

Business Sales & Inventories (*link*): Nominal business sales remained stalled around record highs in October, while real business sales continued to reach new record highs in September, though its pace has slowed. Nominal manufacturing & trade sales dipped 0.5% during the two months through October after climbing 0.3% the prior two months. Meanwhile, real business sales hasn't posted a decline since May, up 1.5% during the four months through September. The real sales of retailers was little changed at its record high in September, while wholesalers' real sales are ascending again—to within 0.3% of January's record. In the meantime, manufacturers' sales remain stalled below January's cyclical high. October's nominal inventories-to-sales ratio (1.40) once again held at its recent high, up from its recent low of 1.34 last June. In the meantime, the real inventories-to-sales ratio remained at 1.45 in September, a tick below its recent high of 1.46; it was at a low of 1.41 at the end of 2017.

Producer Price Index (*link*): The Producer Price Index for final demand was flat in November after a 0.4% gain a 0.3% loss the prior two months. The yearly rate held at 1.1% (the lowest since October 2016), down from a recent peak of 3.4% during July 2018. Prices for final demand goods advanced 0.3% after recovering 0.7% in October from a 1.2% decline during the five months through September. The yearly rate (0.2% y/y) moved back above zero last month after slipping below zero in August for the first time since September 2016. A major factor in the increase in prices for final demand goods was the index for meats, which climbed 3.9%. Final demand services fell 0.3% in November, its second decline in three months, after rising six of the prior seven months. These prices rose only 1.4% y/y (the lowest since March 2017), slowing notably from August's 2.7%. Meanwhile, there's deflation in the pipeline: Intermediate goods prices fell 2.9% y/y in November, easing slightly from October's 40-month low of -3.7%. Crude prices fell 5.5% y/y last month, less than half October's 12.0% decline.

Import Prices (*link*): Import prices in November rose for the second time in the six months, as both petroleum and nonpetroleum prices moved higher last month—the latter for the first time since February. Total prices edged up 0.2% after a 0.5% decline in October and a slight uptick in September. Compared to a year ago, total prices fell 1.3% y/y, narrowing from October's -3.0%—which was the steepest decline since July 2016. Volatile petroleum prices (1.4% y/y) turned positive again, on a yearly basis, after falling for five months, while nonpetroleum prices (-1.4) were below a year ago for the 11th time this year—falling below zero in January of this year for the first time since November 2016. The rate for capital goods imports (-1.8) was in negative territory in November for the 14th consecutive month, while the rate for industrial materials & supplies was negative for the ninth month this year—though the latter is heading back up toward zero. Meanwhile, prices for consumer goods ex autos (-0.4) remained just below year-ago levels, while the yearly change in auto prices was fractionally below zero for the 11th time this year. The rate for food prices (-2.6) was below zero for the third month, after being above the previous three months. Looking at our Asian trading partners, we're importing deflation, with import prices for goods from China (-1.7) and the NICs (-2.3) falling and those from Japan remaining basically flat y/y. Meanwhile, there's no sign of inflation in EU (0.2) import prices, which decelerated sharply from last May's 4.1%, while import prices for goods from Latin America (-4.5) were negative for the 12th month in a row.

GLOBAL ECONOMIC INDICATORS

Eurozone Industrial Production (*link*): Output in October fell for the fourth time in five months, sinking to its lowest level since March 2017. Production began 2019 with a 1.7% jump, though quickly lost momentum, recording only two more gains since then. Industrial production (excluding construction) was down 1.9% during the five months through October. The weakness the past five months was fairly broad-based, with only consumer durable goods (0.5%) eking out a small increase over the period. Here's a list of the output performances for the other main industrial groupings over the comparable time span: energy (-2.6%), capital goods (-1.9), intermediate goods (-1.6), and consumer nondurable goods (-1.2). Consumer goods production excluding food, beverages & tobacco contracted 2.5% over the five-month time span. Of the top four Eurozone economies, German production is by far the weakest, falling 2.7% during the two months through October and -6.3% y/y. France's is the strongest of the four, with output up 0.9% over the past two months, pushing the yearly rate up to 0.1% y/y from -1.6% in October. Meanwhile, production in Spain and Italy both contracted during the two months through October, by 1.3% and 0.7%, respectively, with Spain's (-1.5% y/y) yearly rate negative for the first time in seven months and Italy's (-2.4) decline the steepest this year.

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