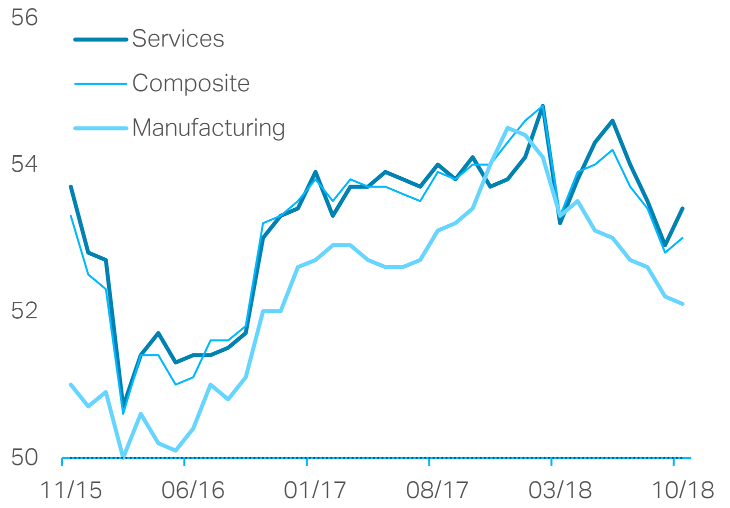
Global Leading Indicators

GLASS HALF-EMPTY

Global Team

- **World economy lacks impetus as DMs lose steam**
- **US economy set to slow in 2019**
- **Germany under pressure as growth tailwinds recede**
- **China on the back foot despite easier policy**
- **Japan, Korea stuck in low gear**
- **India on the mend but macro risks still elevated**
- **Stagnant real wages complicate Australia's macro outlook**
- **Brazil/Mexico looking for direction**

Manufacturing under pressure
Global PMI indices



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SUMMARY

Konstantinos Venetis / Davide Oneglia

Lacking impetus

Improving EM performance has allowed our Global Leading Indicator to consolidate, masking the lack of momentum in the major advanced economies.

Our Global Leading Indicator (GLI) has steadied over the autumn but remains soft, with a more positive tone in the Chinese data making up for weakness in Europe and Japan.

Our US LI points to somewhat slower growth going into 2019. Capital spending plans have softened and the housing cycle has turned. Real interest rates are rising and while real pay growth has improved it is still low. Inflation looks unlikely to spiral out of control, not least as the strong dollar exerts a downward pull on consumer prices. We do not expect the Fed to chase inflation and therefore risk inverting the curve.

Momentum in the euro area has steadied but remains weak. The German surveys point to some involuntary build-up of stock as a result of falling demand, skewing growth risks to the downside in the next quarter. Our UK LI has recovered somewhat but the contraction in business investment amid elevated Brexit uncertainty continues to cloud the macro outlook.

Our China LI has stabilised following a weak H1. Despite the latest policy easing, however, we expect GDP growth to slide further over the next couple of quarters – not least as the impact of export frontloading should start to show in the upcoming trade data. The Indian economy is showing signs of recovery, supported by falling oil prices; but with core inflation high and fiscal slippage still likely, the macro risks remain elevated.

Consensus (q/q)	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	TSL GLI
USA	0.4%	1.0%	0.8%	0.7%	0.6%	**In line**
Euro area	0.3%	0.4%	0.5%	0.5%	0.5%	**In line**
Japan	-0.2%	0.7%	0.3%	0.3%	0.4%	**In line**
Canada	0.3%	0.7%	0.4%	0.5%	0.6%	**In line**
UK	0.2%	0.4%	0.4%	0.3%	0.2%	**In line**
Germany	0.2%	0.5%	0.5%	0.4%	0.5%	**In line**
France	0.2%	0.2%	0.3%	0.5%	0.4%	**In line**
Italy	0.3%	0.1%	0.3%	0.2%	0.3%	**In line**
Spain	0.7%	0.6%	0.5%	0.6%	0.5%	**In line**
Australia	0.4%	0.8%	1.2%	0.6%	0.8%	**In line**
Korea*	2.9%	2.9%	2.1%	3.1%	2.7%	**Below consensus**
Brazil*	2.0%	1.2%	1.3%	1.7%	1.9%	**Below consensus**
Mexico*	1.5%	2.4%	2.3%	2.0%	2.0%	**Below consensus**
India*	7.3%	7.6%	7.5%	7.1%	7.0%	**In line**

** y-o-y change.* A note explaining the methodology and construction of the Global Leading Indicators can be found here.

WORLD

Konstantinos Venetis

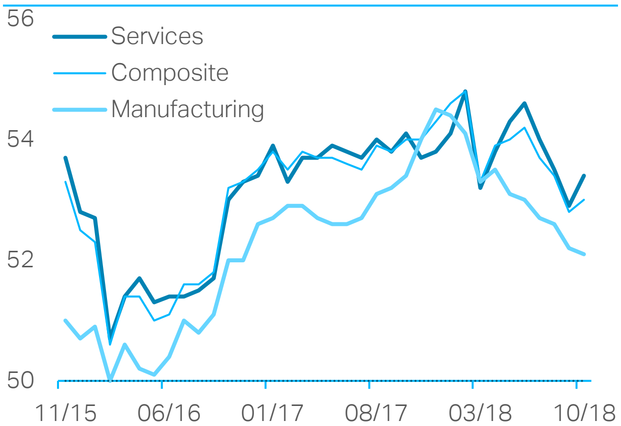
Glass half-empty

With the major DMs lacking impetus and EMs facing multiple headwinds, the stabilisation in our Global Leading Indicator is unlikely to portend a major turning point for the world economy.

Our Global Leading Indicator has found a firmer footing. But with the developed economies losing momentum and the combination of soft Chinese activity with tighter dollar liquidity weighing on EMs, the world economy remains on the back foot. Economic surprise indices in Europe and Japan have worsened during the autumn. While the negative third-quarter GDP readings for the export-dependent economies of Germany and Japan were to some extent the result of one-off factors, they could also be foreshadowing more challenging times ahead. Beijing's reluctance to engage in major fiscal or monetary stimulus suggests the yuan could continue to slide against the dollar throughout 2019, exporting deflation and spreading the pain from the trade war to the rest of the world. The US economy continues to outperform; but there, too, it looks like growth is set slow, moving closer to trend next year.

Manufacturing under pressure

Global PMI indices



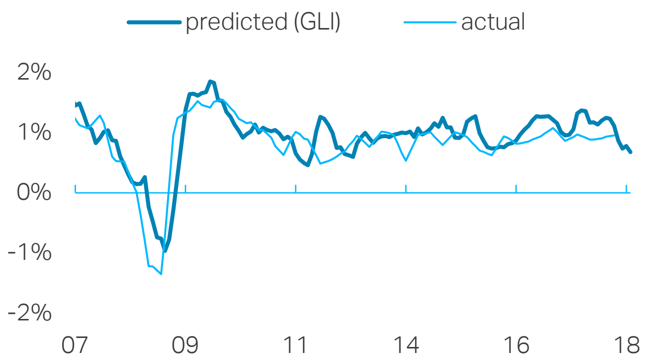
Source: Datastream, TS Lombard

World trade volumes have fared better in H2, but weak export order prints are keeping the pressure on manufacturing, dragging the sector's PMI down to levels last seen in Q4 2016. With the exception of the US, global industrial production has taken a turn for the worse since the spring, driven by weakness in Europe, Japan and (more recently) EM Asia. Business activity in the service sector has improved somewhat, yet it remains to be seen how much of this is payback from recent weather-related disappointment in the US and Japan – not least as corporate sentiment looks fragile.

Despite the overall soft tone in activity, the surveys continue to reflect a steady increase in input price inflation, with higher costs gradually getting passed on to final prices. This is due to the combination of higher wages, tariffs and energy costs – although recent sharp declines in oil prices should take some of the pressure off.

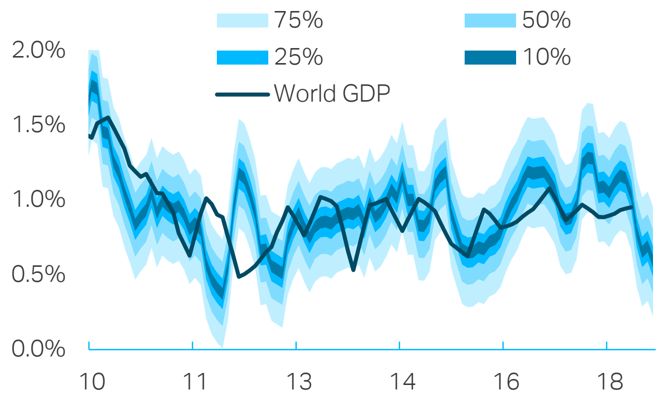
Global Leading Indicator (GLI)

World GDP, QoQ



Source: Datastream, TS Lombard

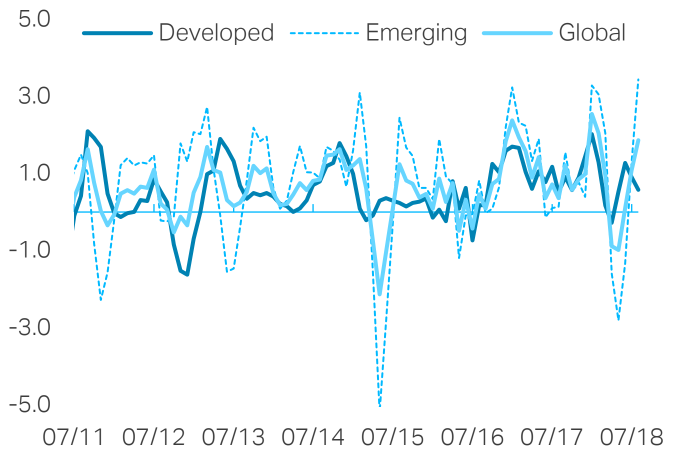
GLI confidence intervals



Source: Datastream, TS Lombard

EM trade momentum improving

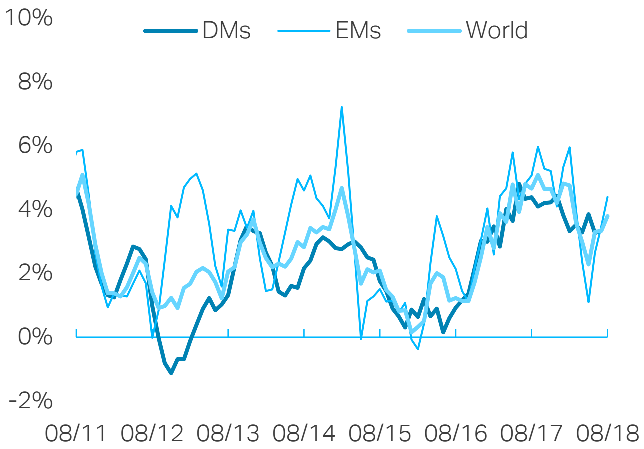
Export volumes, 3m/3m %



Source: Datastream, CPB, TS Lombard

Export volumes stabilising

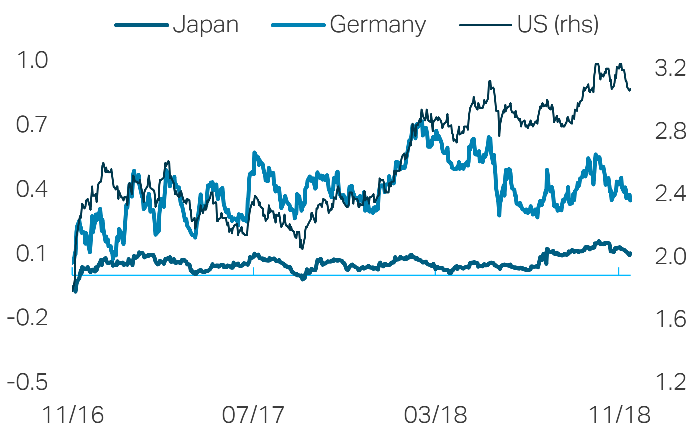
Y/Y, 3m MA



Source: Datastream, CPB, TS Lombard

US divergence on pause

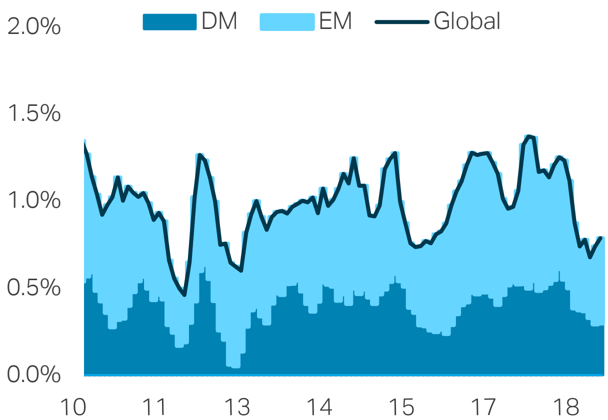
10-year nominal benchmark yields, %



Source: Datastream, TS Lombard

GLI steadying

GLI and components



Source: Datastream, TS Lombard

USA

Steven Blitz

Fed’s new conundrum is arriving

Our LI suggests somewhat slower growth from here, and 2019 looks to be a challenge. The Fed’s narrative will change as they face the conundrum of policy rates not being high by any measure and slowing growth. They will not chase inflation and invert the curve. March is the last hike, and even this is not assured.

Our LI still signals growth dropping from its above trend pace. Consumer spending is strong, financed out of savings, capital spending plans have softened and the housing cycle has turned. Rising real interest rates is one reason, improved but still low real wage growth is another. As for inflation, prices and wages are finally on the upswing but neither looks set to spiral out of control. The underlying forces are still more disinflationary than not, and the strong dollar adds to the downward pull on consumer prices.

The Fed’s “dot plots” aren’t yet on life support but sentiment at the Fed suggests their days are numbered. Last week a press release announced a conference next June at the Chicago Fed, an “outreach” in Fed terms, to “review the strategies, tools, and communication practices it uses to pursue its congressionally assigned mandate” Fed Chairman Powell says that “now is a good time to take stock of how we formulate, conduct, and communicate monetary policy…”.

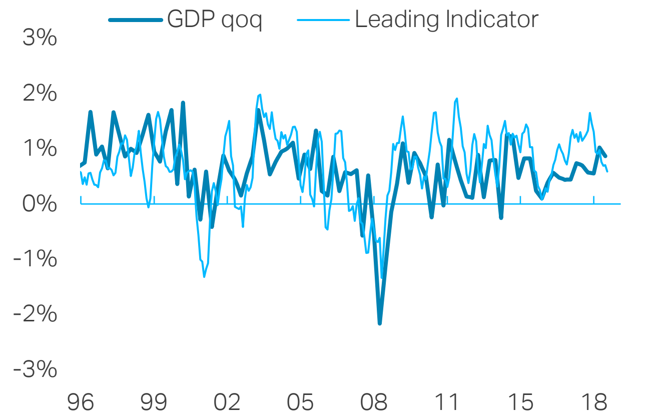
They want to look at alternatives now because the current projection of policy has little value if the Fed wants to stop hiking and convey that “neutral” has been reached (they will never halt and proclaim the next move is an ease; they would just ease). We have noted before how the current trajectory is essentially a fiction because FOMC members understand the market implication of going public with a flat or falling funds rate forecast. The consequence is everyone forecasts sustained expansion even though they all know the probability of this outcome demanding another 100 basis point increase in policy rates is getting smaller.

Probabilities are shrinking, by Powell’s own admission at his recent appearance at the Dallas Fed, because headwinds to growth are increasing and the economy has still to fully absorb the lagged impact of eight rate hikes. Yet, at the same time, monetary policy can hardly be considered tight. Carrying costs are still well below nominal growth in final sales of domestic product. Credit standards, more importantly, are still being eased- the normal state of affairs when the yield on the two-year Treasury is above the federal funds rate.

Whether for regulatory reasons or not - and we suspect the explanation is increased capital requirements and scrutiny of loan quality - bank lending to nonbank financial institutions has been expanding more rapidly than commercial and industrial loans. The funds nonbanks draw are intermediated to borrowers either directly or by funding CLOs. Banks have less of a direct credit profile than in the prior expansion, and certainly have more capital, but exposure is still there through these loans and, indirectly, by their credit exposures in other areas to nonfinancial firms that are doing the borrowing.

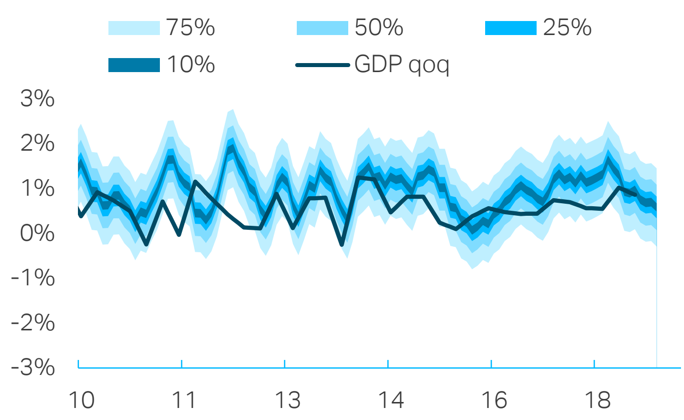
Markets seem to have got the drift of what Powell has been implying, the implied funds rate in the futures contract 24 months out has dropped to 2.75% from near 3.00%. The FOMC’s latest median dot plot forecast for two years out is 3.4%. The Fed is seeking a graceful exit from having to publish these dots.

LI points to weaker growth



Source: Datastream, TS Lombard

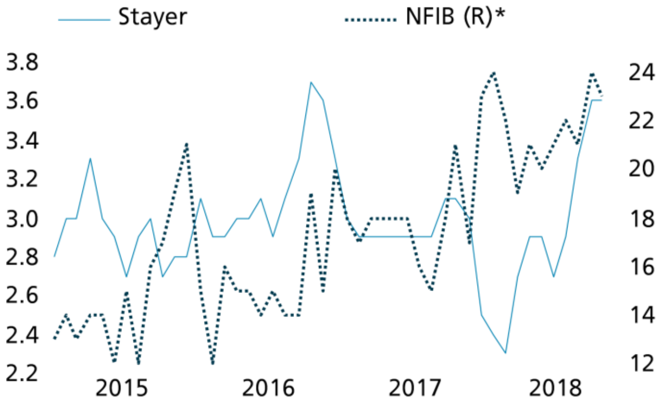
LI confidence intervals



Source: TS Lombard estimates

Wage Growth for Job Switchers vs Stayers

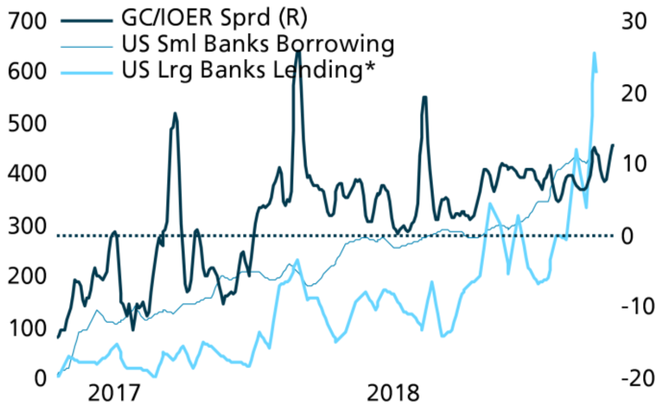
* % of NFIB firms planning to raise wages



Source: Thomson Reuters Datastream, TS Lombard

Fed Funds Sold & Rev RPs* vs GC/IOER Spread

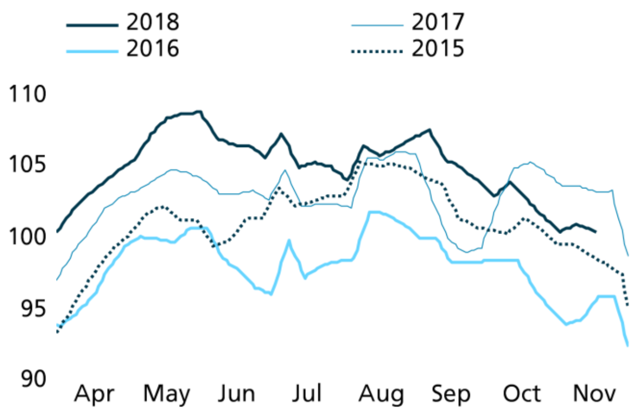
Cumulative Change Since QT Began



Source: Thomson Reuters Datastream, TS Lombard

Railcar Loadings Cyclical Cargo (000s)

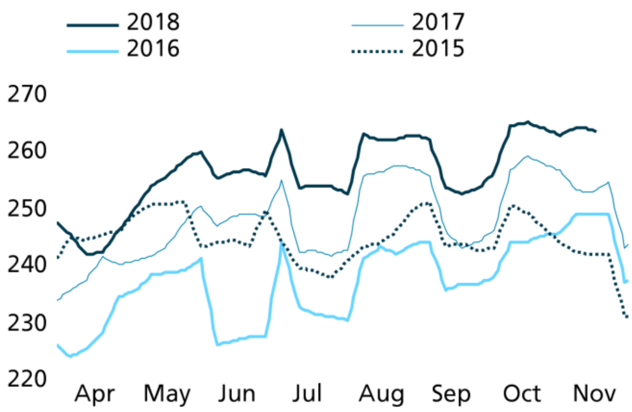
Chemicals, Metal, Nonmetallic & Forest Prod -- 4Wk Mov Avg



Source: Thomson Reuters Datastream, TS Lombard

Railcar Loadings of Containers

(4W Mov Avg, 000s of Carloads)



Source: Thomson Reuters Datastream, TS Lombard

CHINA

Rory Green

Deleveraging pause too late for Q4/18

Our LI is forecasting a continued turnaround in Q1/19. We are more bearish, the LI does not factor in the impact of export frontloading which should begin to negatively affect the economy early next year.

We expect GDP growth to continue to fall in the next two quarters, despite the latest policy easing. In September, Beijing accelerated fiscal spending and removed a tightening bias from monetary policy. The most recent political indications point to an expansion of existing easing policy. Earlier this month the politburo omitted the term "controlling leverage" from its latest statement officially formalising a temporary pause in authorities' deleveraging drive.

Pre-existing support measures caused investment to recover modestly in October. FAI growth increased over the previous month, led by a rebound in manufacturing 9.10% ytd yoy. The now explicit pause in the deleveraging drive is an expansion on prevailing stimulus measures but will fall far short of previous China credit easing. Nevertheless, we expect credit and investment numbers to bottom out in Q4/18, we retain our forecast for sub 6.5% yoy GDP growth in H2/18.

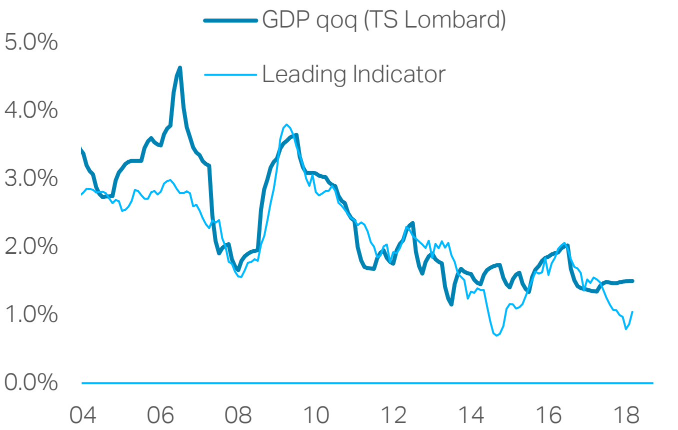
Trade data is showing limited frontloading. Chinese exports rose 12.6% yoy ytd in October on stronger demand and a weaker CNY. Domestic import demand continues to belie a softening domestic economy. We expect frontloading to show clearly in November and December trade data. Regardless of the outcome of the Trump-Xi meeting next week there will be an export slowdown in Q1/2019 as demand for Chinese imports has already been brought forward ahead of expected tariff hikes in January. Our discussions with Chinese exporters and NBS new export orders PMI indicate orders for 2019 have been weak.

Credit data for October show monetary policy remains relatively tight. Our measure of Total Social Financing adjusted for local government bond issuance slowed, increasing at 11.5% yoy*. The decline in shadow bank financing continued, while local government bond issuance slowed after massive policy induced issuance the previous month.

We expect looser credit policy to cause infrastructure investment to pick up in the coming months supporting aggregate FAI. Infrastructure has been the weakest component of overall investment growth in 2018, at just 0.8 % yoy YTD. This largely stems from the slow issuance of bonds in H1/18, and government restrictions on infrastructure projects. With both limits easing we expect monthly infra investment will rebound in Q4/18.

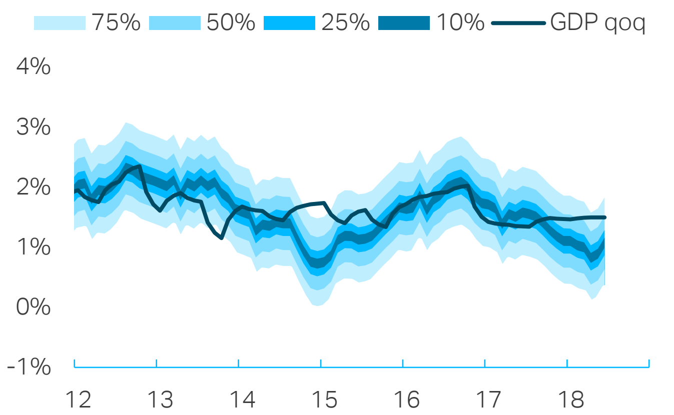
**We urge caution interpreting the PBoC's TSF series. In September the bank changed its calculation method to include local government special purpose bond issuance in TSF.*

LI picking up on stimulus



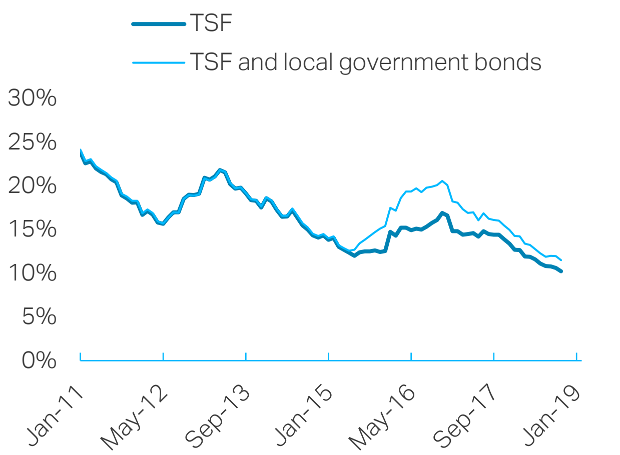
Sources: CEIC, TS Lombard

LI confidence intervals



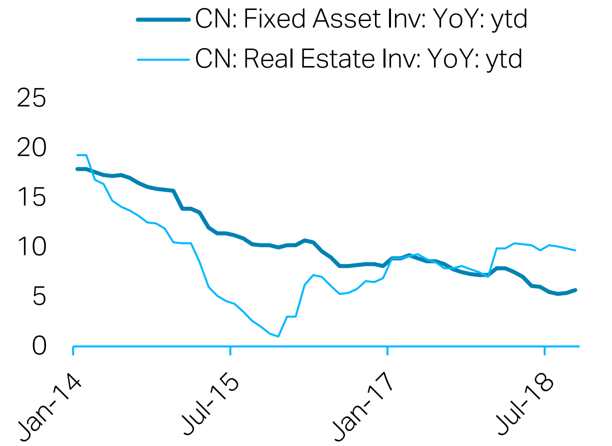
Sources: TS Lombard estimates

Total credit growth



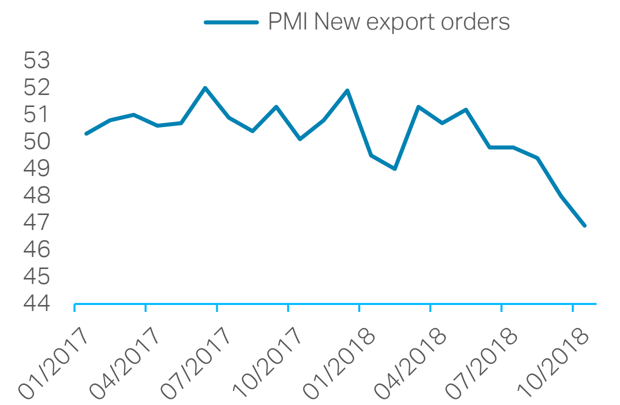
Sources: CEIC, TS Lombard.

Investment to rebound in Q1/19



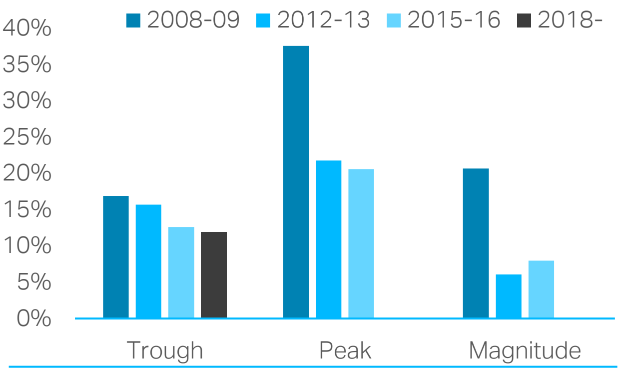
Sources: CEIC, TS Lombard.

Export orders spell trouble for Q1/19 trade



Sources: CEIC, TS Lombard.

Magnitude of credit easing will dissapoint



Sources: CEIC, TS Lombard.

EURO AREA

Shweta Singh

Slowing growth, increasing divergence

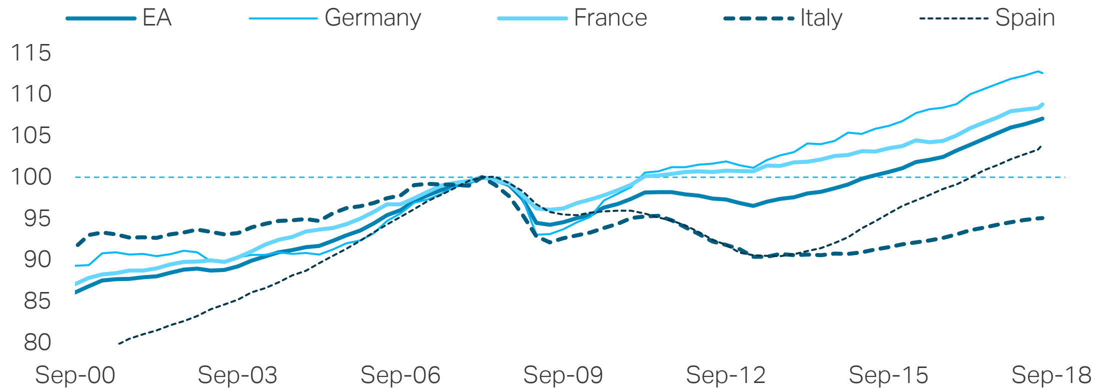
EA growth halved in Q3. Germany was the key drag, followed by Italy. But France and Spain rose at a healthy pace. Idiosyncratic factors have exaggerated the Q3 slowdown. But even if we set aside these temporary causes, EA expansion has lost momentum.

Euro area real GDP expanded by 0.2% in Q3 over the previous quarter, disappointing expectations. The pace of growth halved from the 0.4% increase in Q2. Deteriorating global growth and trade has hit EA manufacturing particularly hard. The fall in the yuan and other emerging market currencies has damaged eurozone's relative competitiveness. At the same time, Italian policy risks refuse to go away.

Germany was the biggest drag on EA's Q3 growth. Real GDP declined by 0.2% in Q3, following a e 0.4% expansion in Q2. Idiosyncratic factors, in particular the bottlenecks in the implementation of the new emission testing standards for autos, exaggerated the slowdown in Q3. Higher oil prices over the summer dented private consumption. But oil prices have declined recently and the drag from new testing standards should fade away. Yet, even if we set aside these temporary factors, there is a definite loss of momentum in Germany and the rest of the eurozone. Meanwhile, the Italian economy stagnated in Q3, following a 0.2% gain in Q2. The deterioration in Italian growth is not surprising given the risk-off sentiment amid continued tension between the Italian government which is pushing for an expansionary fiscal policy and the European Commission.

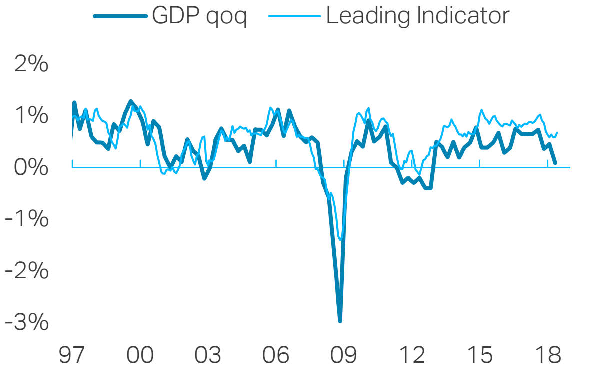
EA expansion slows; growth divergence increases

Real GDP, indexed to Q1 2008=100



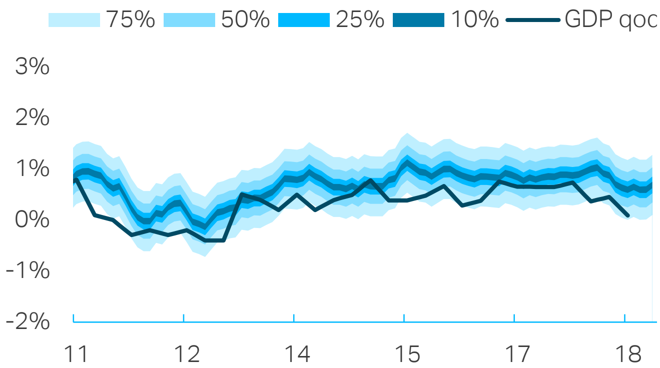
It is not all bad news, however. Quarterly real GDP growth in France accelerated 0.4% from 0.2% in Q2. The underlying details show a healthy domestic demand momentum with decent gains in private consumption and fixed capex. The Spanish economy also held up well, expanding by 0.6% in Q3, similar to the gains in the preceding quarter. We expect EA expansion to accelerate in Q4 to 0.4%-0.5% as temporary factors holding down German growth fade. Still, the eurozone growth momentum is ebbing. 2018 growth could be around 1.5%, lower than 2.5% in 2017. The ECB and consensus expectations (Bloomberg) of a 2.0% growth this year seem optimistic.

EA LI forecats slower but decent growth



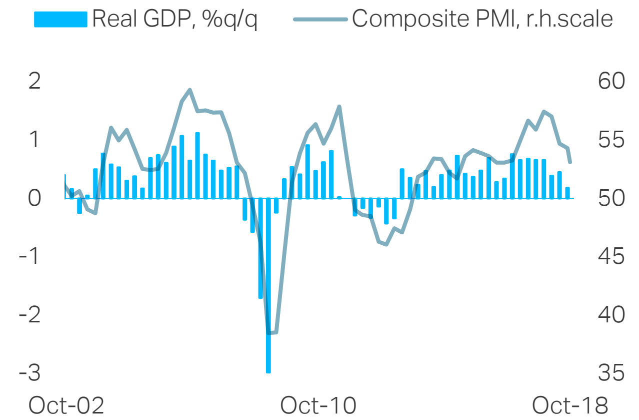
Source: Datastream, TS Lombard

LI confidence intervals



Source: TS Lombard estimates

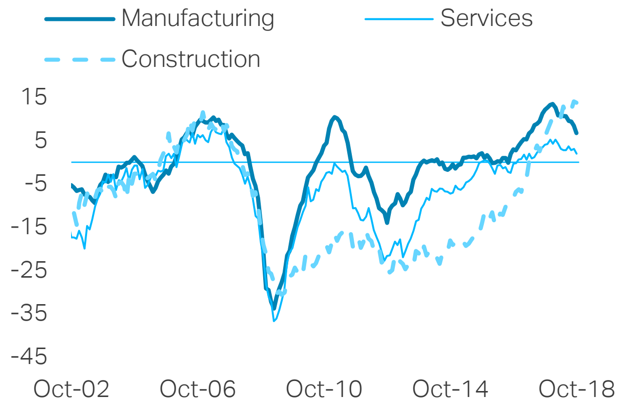
PMIs forecast slower growth



Source: Datastream, EC, TS Lombard

Manufacturing confidence lower

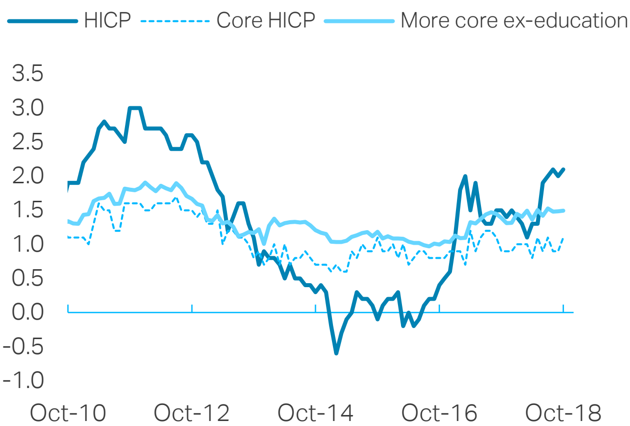
Net balance, deviation from long-term mean



Source: Datastream, TS Lombard

Underlying inflation stable at 1.5%

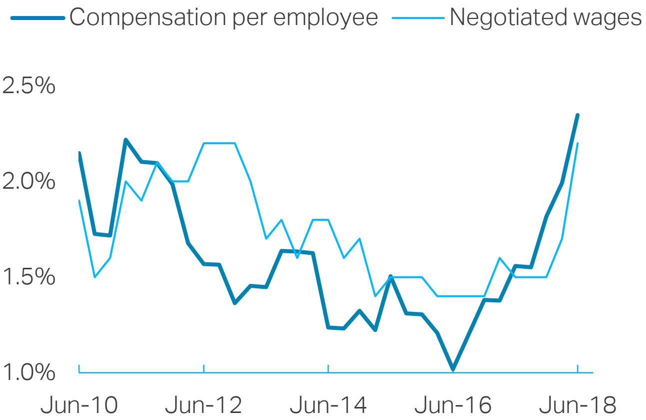
% annual change



Source: Datastream, TS Lombard

Wage growth picks up sharply

% annual change



Source: Datastream, ECB, TS Lombard

JAPAN

Konstantinos Venetis

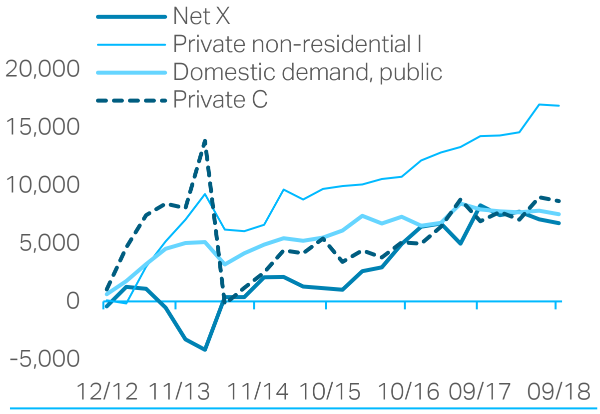
Clouds gathering

The risks to Japan's macro outlook are skewed to the downside against a backdrop of mounting headwinds to external demand and rising precautionary household saving.

Our LI remains weak. The economy stalled in Q3 following a solid second quarter. Real GDP growth contracted 0.3% Q/Q, or 1.2% in annualised terms. The weakness was broad-based, with consumption, investment, inventories and foreign trade all making negative contributions. While a string of natural disasters is partly to blame, the broader message is that the balance of risks to Japan's macro outlook looks skewed to the downside.

Capex dependence

Since Q3 '12, constant prices (JPY bn)

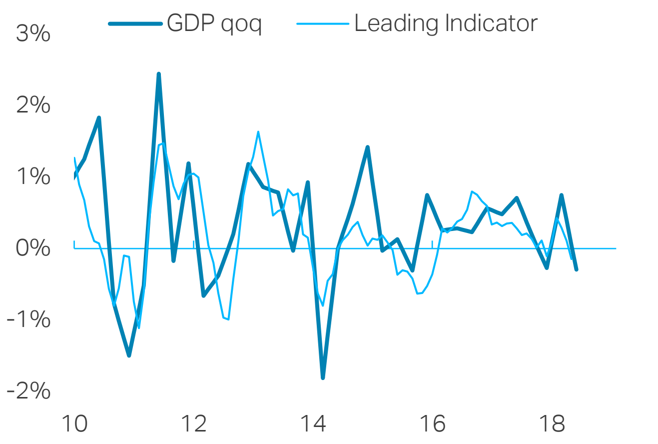


Source: Datastream, TS Lombard

Exports fell 1.8% Q/Q in the third quarter, the largest decline in over three years. Shipments rebounded in October (+8.2% Y/Y, from a negative 1.2% in September) but, with demand from China slowing, a sustainable recovery could prove challenging. Consumption continues to lag the pick-up in incomes. The household savings rate has risen by around 1% of GDP this year, despite seven consecutive quarters of growth in workers' salaries. There are also signs of exhaustion in the domestic capex cycle – a key driver of economic growth in recent quarters – not least as the bulk of the pre-Olympic boom in construction activity is now behind us. After all, with the share of private investment in GDP rising to around 17%, the highest in three decades, diminishing returns are likely to set in.

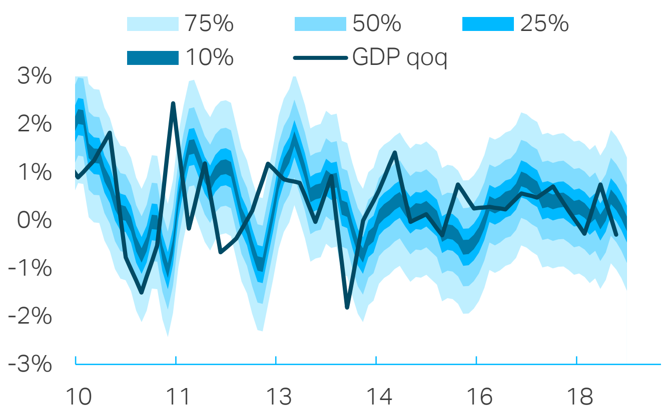
High-frequency indicators paint the same picture. Industrial production is on the back foot (down 0.4% M/M in September). Growth in machine tool orders turned negative in October for the first time in two years, confirming the loss of momentum. The latest PMIs show improvement, driven by the service sector. But with capacity utilisation down to 2016 levels, manufacturing sentiment continues to lack impetus. While the Eco Watchers survey's current conditions index has stabilised after a weak H1, the expectations and employment indices are still pointing down. All this suggests that, with the BoJ adopting a more pragmatic stance, the spotlight will continue to shift to the fiscal 'put' from Shinzo Abe's pro-growth objectives.

LI lacking impetus



Source: Datastream, TS Lombard

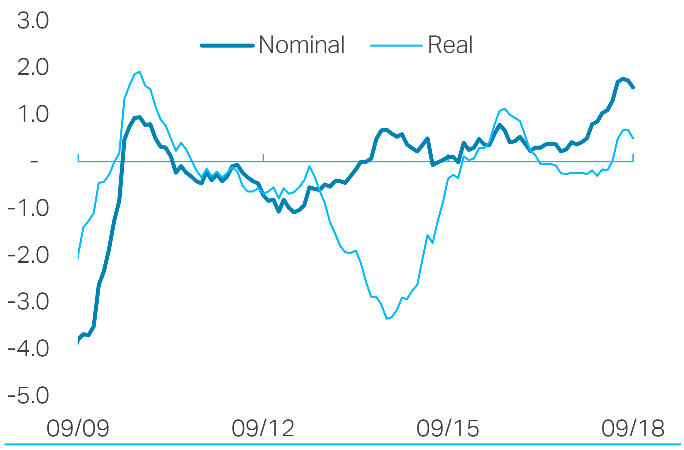
LI confidence intervals



Source: TS Lombard estimates

Pay growth taking a breather

Y/y % changes, 6m MA



Source: Datastream, TS Lombard

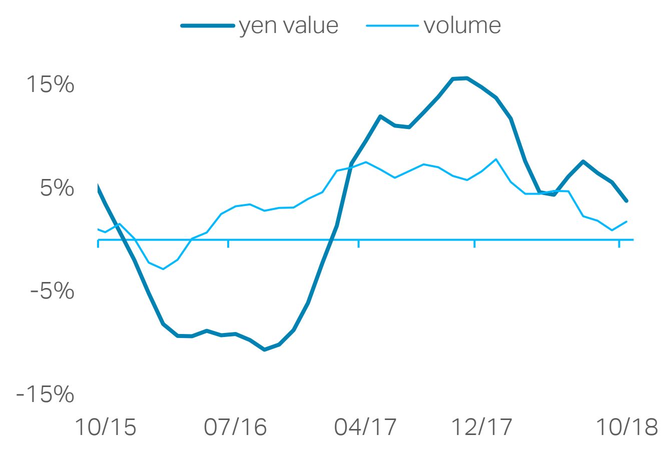
Job creation cooling

3m MA vs previous year

Source: Datastream, TS Lombard

Slower exports in 2018

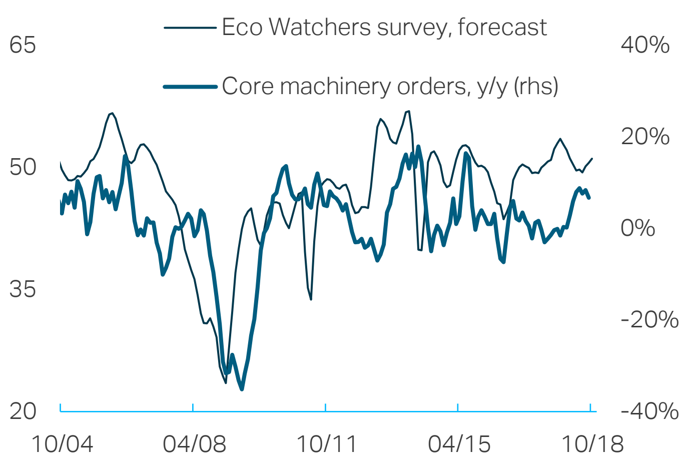
Y/Y changes



Source: Datastream, TS Lombard

Expansion 'on' for now

3m MA



Source: Datastream, TS Lombard

CANADA

Steven Blitz

Sustained slow growth

LI is stable at a low 0.2%. Consumer weakness, including housing, and a slower US economy are mostly to blame. A pick up in net exports, oil production and capital expenditure should keep real growth above 1.5%. The BOC will boost rates again January, following the Fed's hike in December, but as with our view on the Fed, probably only one more after that.

The Canadian economy's early year surge, notably in Q2, will carry full year growth to 2%. Recent data, reflected in our LI, show the economy softer but sustaining just enough forward momentum for H2 real growth come in around 1.5% to 2.0%. This will be good enough for the BOC to boost rates another 25 basis points in January, following the Fed's December hike. Looking forward to next year, with slower global growth and the BOC raising rates further, we anticipate real growth closer to 1.5%.

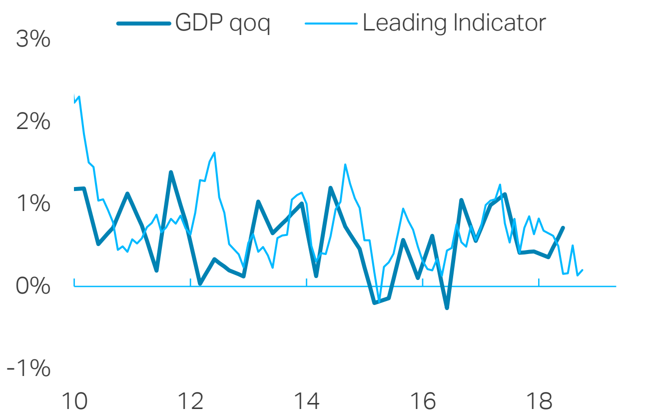
The 11,000 rise in October employment tied to gains in full-time employment, part-time employment fell off. Nevertheless, looking at employment gains on a YTD basis, they come out of full-time job growth but this still isn't much – only 0.8%. On a YoY basis, employment growth is on a steady downswing since the end of 2017. In October of 2017 growth 3%, it is now 1.2%. Jobs are jobs, however, and income is growing with it, and so too is retail sales excluding autos and gas.

Higher rates and tighter credit conditions were put in place to slow housing and they have worked. Even though housing starts picked up in October, the overriding three-month trend is lower. The current pace of starts is just under 200,000 – the lowest since 2016.

What will drive growth is capital spending to boost capacity. Industrial capacity utilization was 85.5 in Q2, essentially taking it back to pre-recession highs. Utilization tended to top out at around 86.5% starting in the mid-1990s. Here is where the USMCA should benefit. While final passage in the US is not assured, now that the Democrats control the House of Representatives, the threat of major trade disruptions have eased back. What is more risky for capital spending is oil prices and a softer global economy.

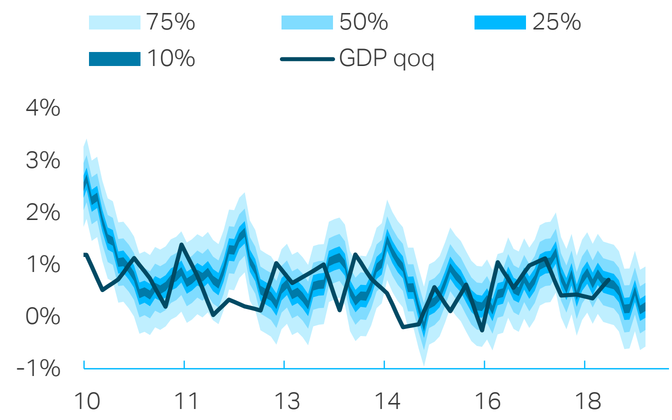
The BOC will ignore growth trends, keep its eye on the Fed, meaning the Can$, and cite low unemployment and high utilization as the domestic reasons to keep to its task of normalizing rates. In other words, as long as the Fed hikes rates in December as expected, so too will the BOC. Because we think March is the last Fed hike for the year, we extend this trajectory to Canada as well. After the BOC January hike, one more at most.

LI finding a floor, GDP to follow



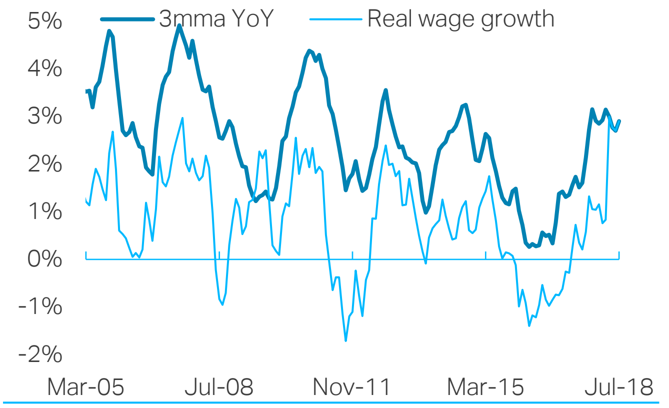
Source: Datastream, TS Lombard

LI confidence intervals



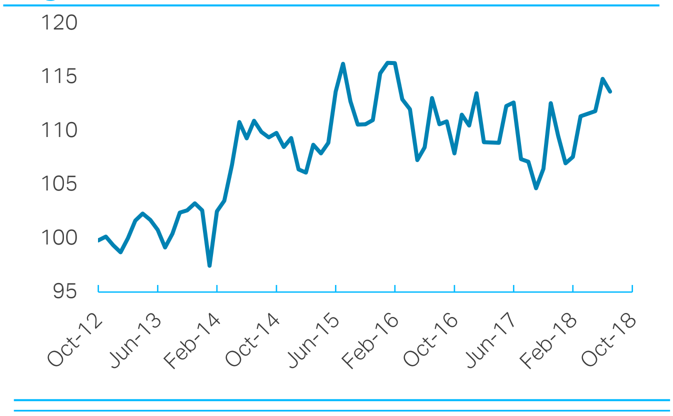
Source: Datastream, TS Lombard

Wage growth beginning to slow



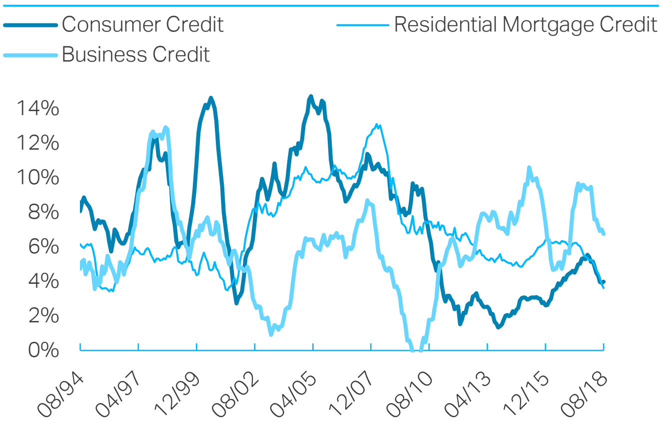
Source: Datastream, TS Lombard

Noncommodity exports boost growth



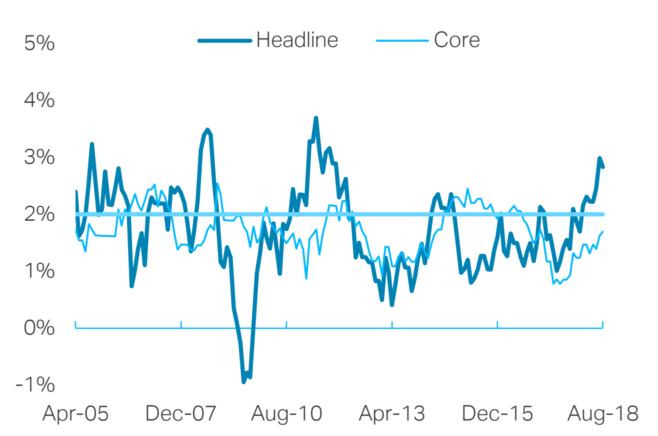
Source: Datastream, TS Lombard

Credit growth is declining



Source: Datastream, TS Lombard

Inflation on the upswing



Source: Datastream, TS Lombard

UK

Konstantinos Venetis

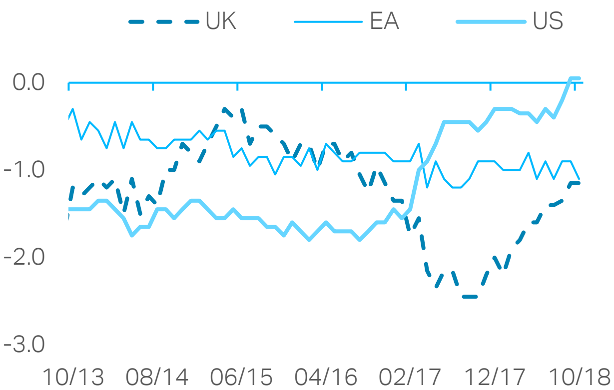
Brexit blues

Economic activity picked up in Q3, but business investment is missing in action amid elevated Brexit uncertainty. The economic policy mix is changing as we reach the end of the road for both fiscal austerity and monetary policy supremacy.

Our LI has recovered from the spring lows. Economic activity picked up in the third quarter, with headline real GDP expanding by 0.6% QoQ. Exports rebounded, government spending picked up and household consumption held steady. Elevated Brexit uncertainty is keeping corporates uneasy, however. Business investment contracted for the third consecutive quarter (-1.2% QoQ), while imports (flat on the quarter) are stuck in low gear. The high-frequency data also point to softer momentum in the autumn, in line with the weak October PMIs.

Catching up

Policy rate adjusted by core CPI, %

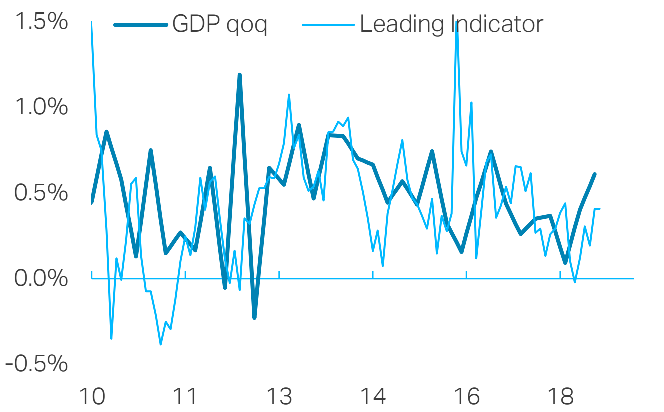


Source: Datastream, TS Lombard

The MPC's latest economic assessment sees GDP growth at around 1¾% over the forecast period, little changed from August. But the Committee views risks to its central projection as skewed to the upside. Household consumption is expected to grow in line with rising real incomes, underpinned by faster wage growth – annual regular pay growth reached 3.2% (0.9% in real terms) in September. Business capex is expected to pick up as Brexit uncertainty recedes and the net impact of the new Budget measures "has the potential to be significant", according to Governor Carney. At the same time, the pace at which the labour force is expanding is expected to slow; and deficient investment means the scope for a swift productivity revival is limited. As a result, the Bank now sees excess demand pressures starting to emerge a year earlier (in 2019) and inflation returning to target a year later (in 2021) than previously anticipated. The MPC's "gradual and limited" path now points to three hikes in the next three years.

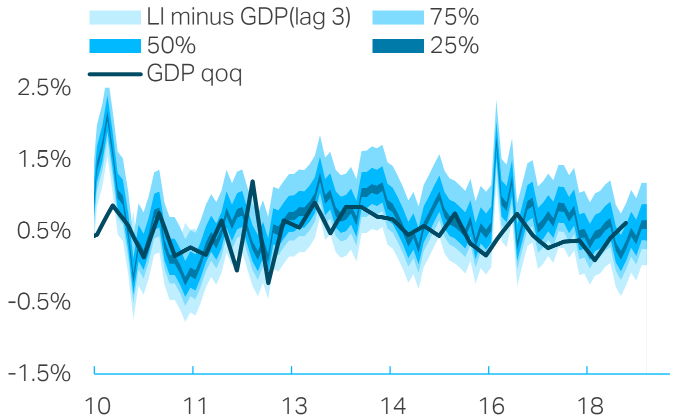
All this, of course, is conditioned on a smooth adjustment to Brexit. Yet it is important to recognise that the nascent realignment in economic policy is largely independent of the type of deal (or no deal) we eventually get. Brexit is bound to inject more (perhaps a lot more) macro volatility over the coming quarters, but the direction of travel for the policy mix is relatively clear. The fiscal stance is getting looser and monetary policy progressively tighter.

LI off the lows, still fragile



Source: Datastream, TS Lombard

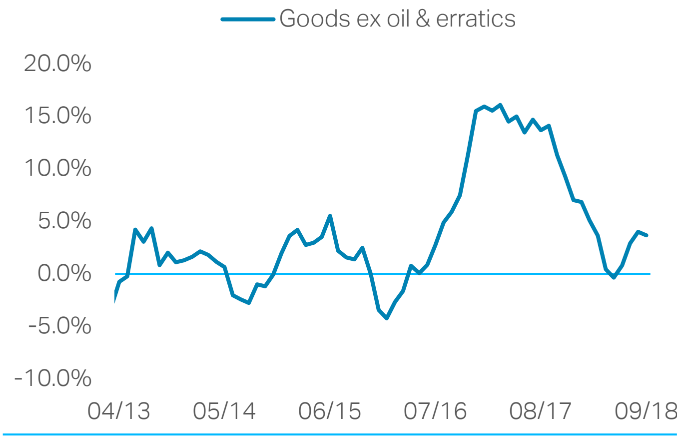
LI confidence intervals



Source: TS Lombard estimates

Exports picking up

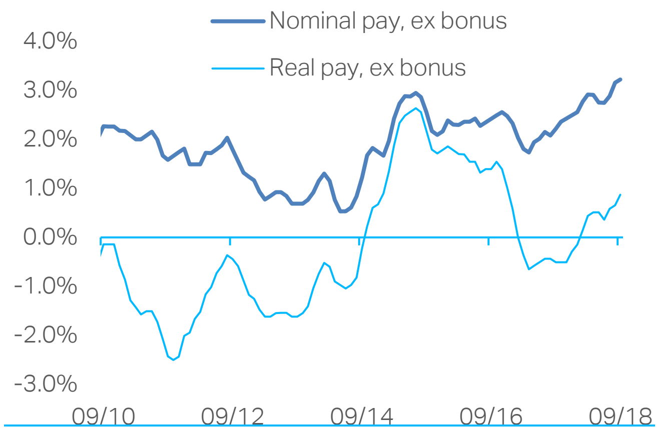
YoY change in 3m MA



Source: Datastream, TS Lombard

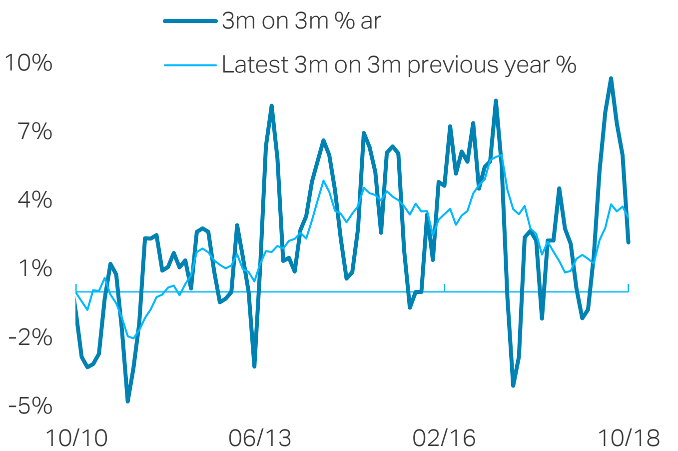
Real wages on the rebound

Average weekly earnings, 3m MA, YoY



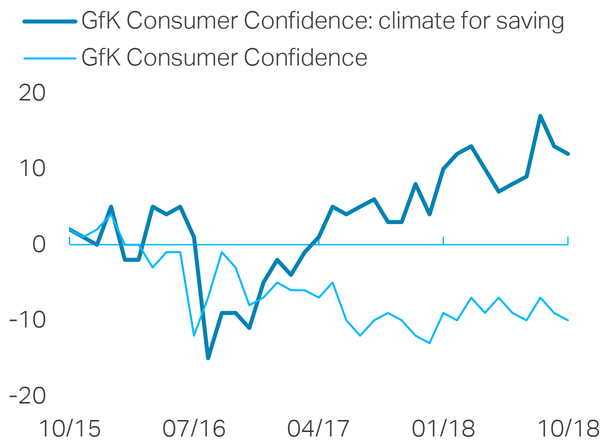
Source: Datastream, TS Lombard

Retail sales stabilising



Source: Datastream, TS Lombard

Cautious households



Source: Datastream, TS Lombard

GERMANY

Shweta Singh

The German locomotive sputters

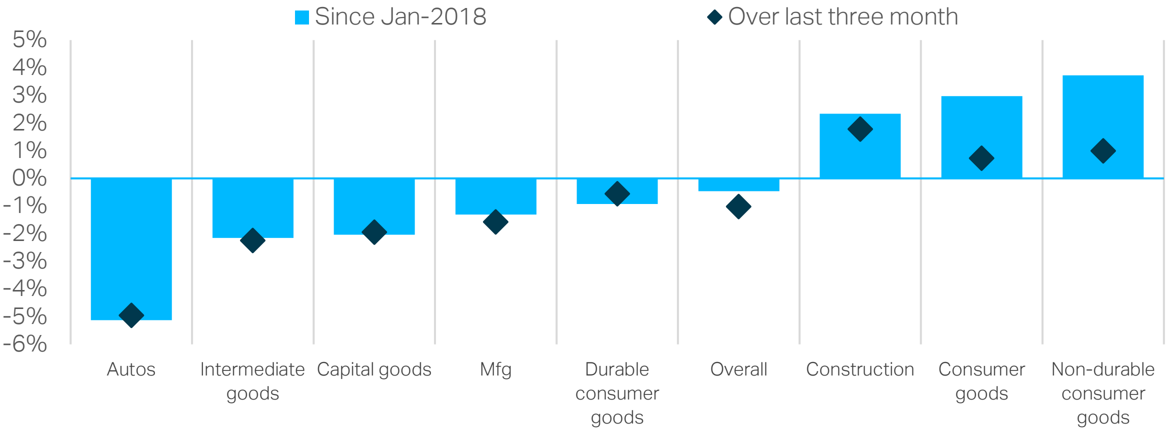
Real GDP declined by 0.2% in Q3. Growth should revive in Q4 as temporary headwinds from new emission regulations and higher oil prices fade. Even so, weak global demand will continue to weigh on the pace of German expansion.

Real economic output declined by 0.2% over the quarter in Q3. The fall was slightly bigger than the consensus forecast (Bloomberg) of a 0.1% decline. We don't have the detailed breakdown of GDP into components. But according to the press release by Destatis, the decline in real GDP was mainly due to a fall in net exports. Exports were down while imports were up. Domestic demand was mixed. Fixed capex in machinery and equipment and in construction was higher than in the previous quarter. But private consumption declined.

Germany is one of the most export-oriented economies globally. The slowdown in global growth and external trade has hit German exports particularly hard. Exports at 50% of GDP, almost equal to consumer spending in constant prices. As a result, their decline is clearly a major factor in slowing German growth momentum. Industrial production fell by 0.9% in Q3 over Q2. Trade-related uncertainty has been the main drag, with output in the export-orientated capital goods sector continuing to fall at a brisk pace.

Industry output deteriorates due to autos and export-focussed sectors

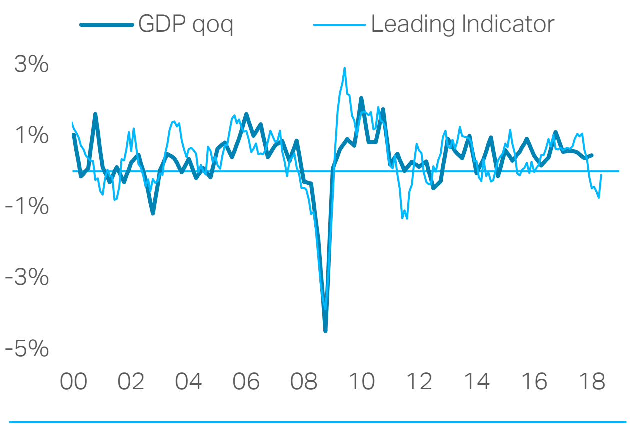
% change in industrial production, September 2018



Source: Datastream, TS Lombard

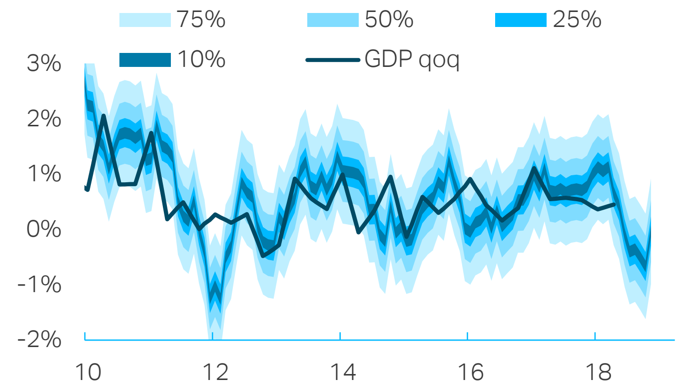
But idiosyncratic factors have exaggerated the decline. Specifically, all new EU car models must pass a new emission standard test, WLTP. But the implementation of these new rules has suffered due to operational bottlenecks, leading to a surge in inventories and a fall in auto production, especially during Q3. Autos production fell by 6% in Q3, the sharpest decline since 2014. Similarly higher oil prices during the summer have likely led to a decline in private consumption. But with oil prices having pulled back since then and nominal wage growth accelerating at a brisk pace, private consumption should strengthen. The drag from the new emission regulations should also fade. Even so, the headwind from dwindling global demand will continue to exert downward pressure on the pace of German expansion.

German LI exaggerates growth slowdown



Source: Datastream, TS Lombard

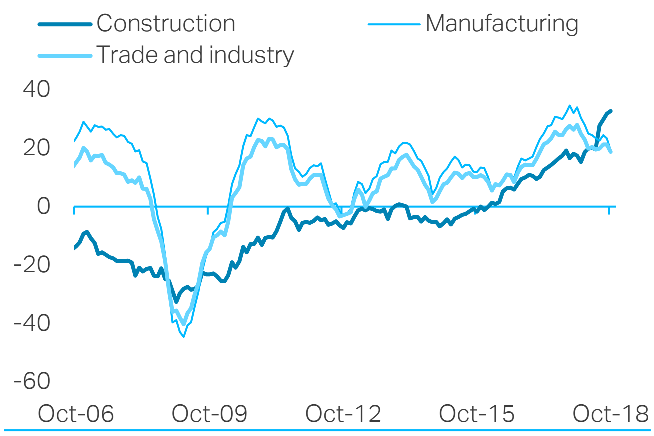
LI confidence intervals



Source: TS Lombard estimates

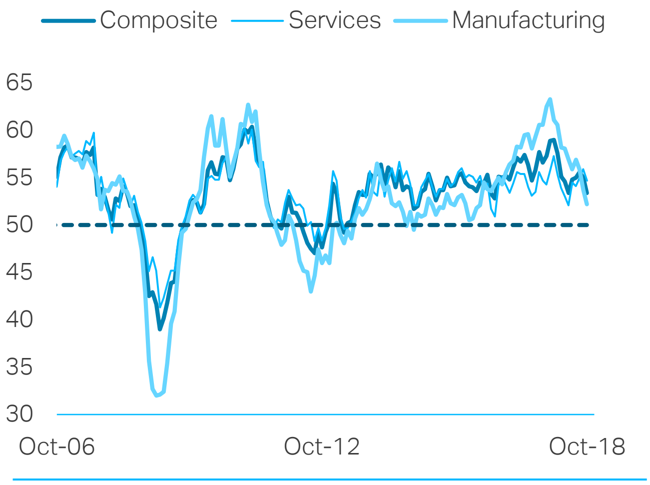
Manufacturing confidence softens

IFO, Business Climate index



Source: Datastream, TS Lombard

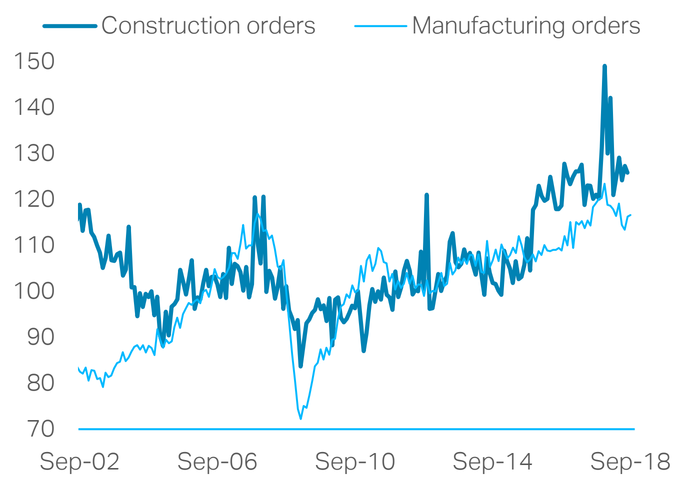
Germany PMIs weaken further



Source: Datastream, Markit, TS Lombard

Orders struggle to bounce back

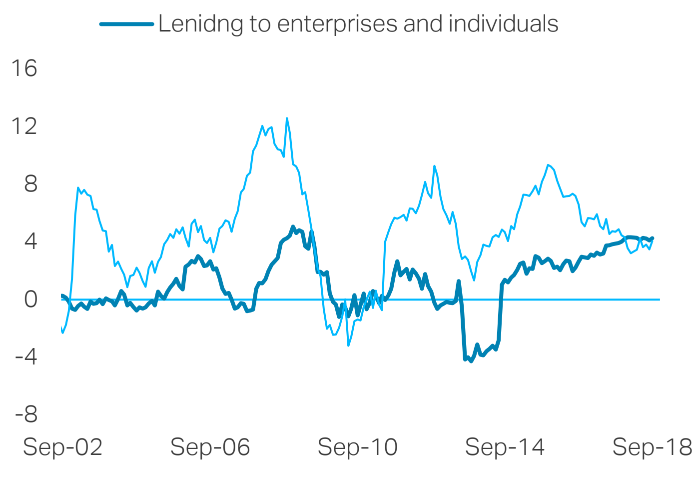
New orders index, indexed to Jan-13=100



Source: Datastream, TS Lombard

Easy liquidity conditions

% annual



Source: Datastream, TS Lombard

FRANCE

Davide Oneglia

Domestic demand holds up, but capex plans?

Our stable LI gets vindicated. Orders and industrial production remain on a gradual downward trend. PMIs signal resilient domestic demand, but latest business survey questions the extent of capex growth this year.

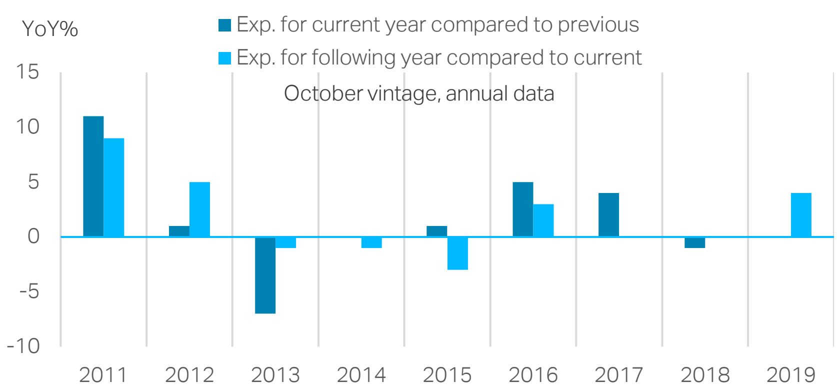
Our French LI, which has been signalling stable growth for some time looking through Q2 jitters, has been vindicated. Moreover, currently, it's still consistent with above-trend growth for the next three to six months.

While, as we noted last month, monthly export data suggest that trading activity with China has caught up again, industrial production data remain weak and orders, both foreign and domestic, have continued to decline in aggregate through October.

Most of these developments are reflected in GDP details for Q3. As the bottom-left chart overleaf shows, while the contribution from net export rebounds (from 0.1 to 0.6% YoY), that from capex shrinks (from 0.3% YoY in Q2 to 0.8% in Q3) as we have been anticipating. What's more, however, is that, despite the efforts from the government and supportive credit supply, more explicit signs that capex expansion has limits are coming also from industry surveys. The chart below reports the results of the latest (October) survey of firms' capex plans. Investment growth for the current year is confirmed to slow compared to last year, but capex plans for 2019 are expected to remain buoyant (4% growth compared to this year).

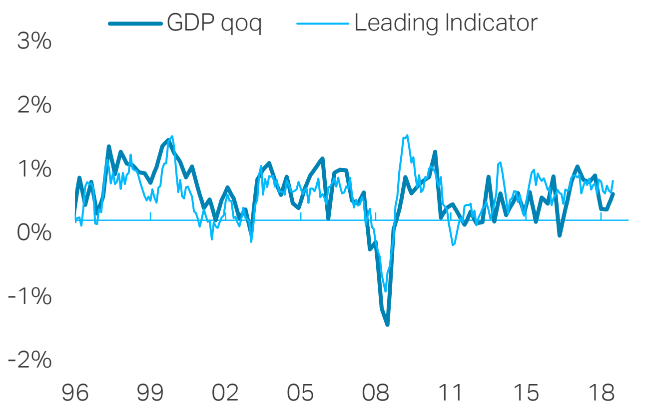
PMIs underscore manufacturing weakness (slowing although still in expansion territory), but, on the flip side, they also point to stronger domestic sector. Indeed, while the construction sector PMI climbs back into expansion territory, the service sector one stays its course. This is consistent with consumption resilience in Q3 (growing steadily at 0.4% YoY, i.e. at the same rate as in Q2), which, in turn, reflects a combination of still tight labour market and wage growth such to offset the impact of brisk headline inflation on real wages.

Investment growth is revised down for 2018 but holds up for 2019



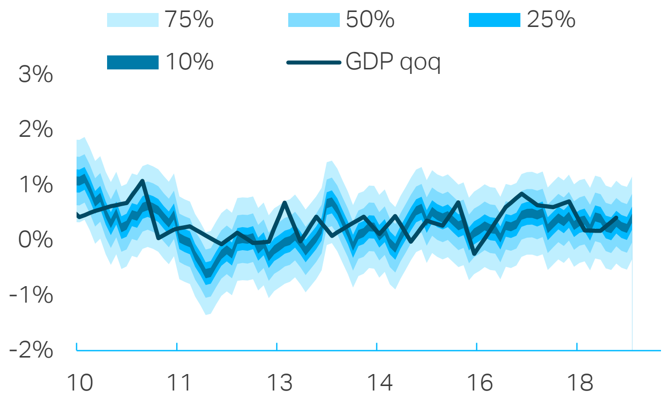
Source: INSEE, Datastream, TS Lombard

The LI is stable



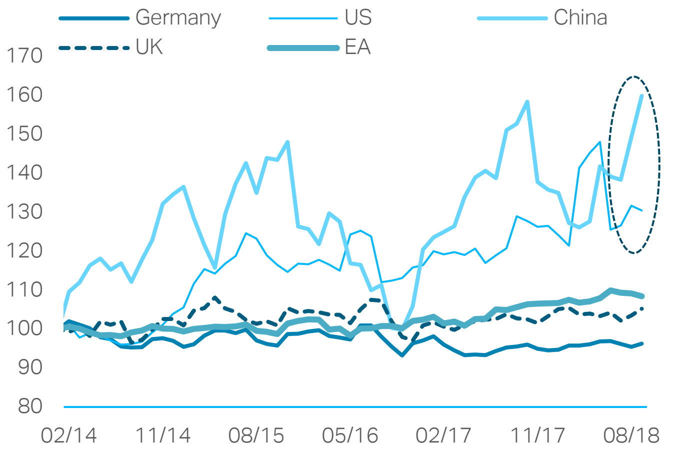
Source: Datastream, TS Lombard

LI confidence intervals



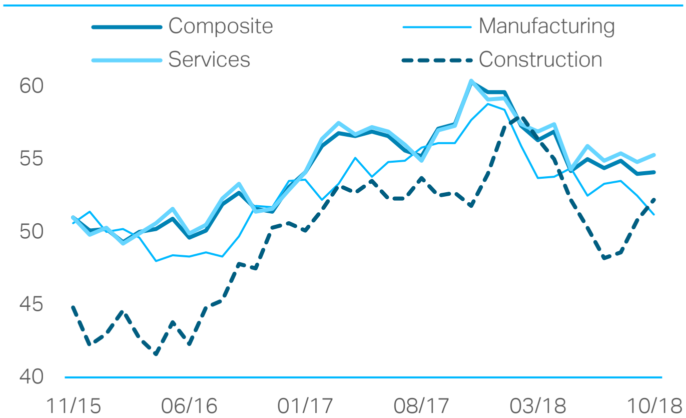
Source: TS Lombard estimates

Some respite from export pains



Source: nat. sources, Datastream, TS Lombard

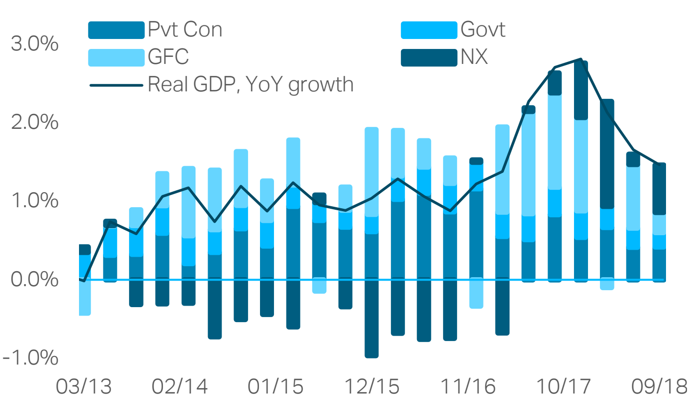
PMIs highlight domestic demand strength



Source: Markit, Datastream, TS Lombard

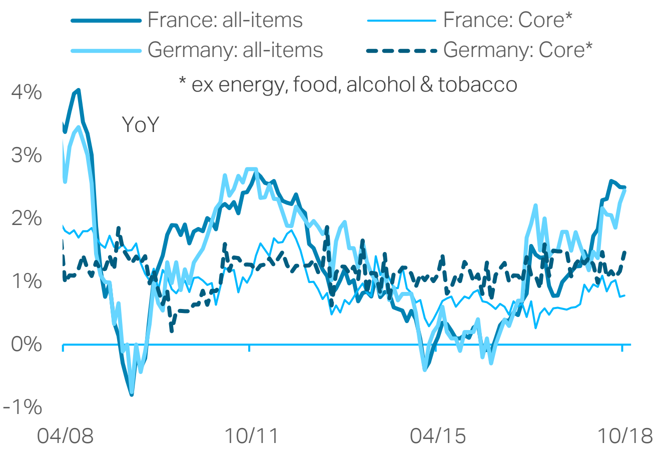
GDP contributions

Percentage points contribution (YoY)



Source: INSEE, Datastream, TS Lombard

Strong headline but weak core



Source: Eurostat, TS Lombard

ITALY

Davide Oneglia

Grim future as growth slows further

The LI edges lower. Global activity weighs on industrial production. PMIs enter contractionary territory and job market loses steam. High risk premia and continuous capital flights can prove unsustainable.

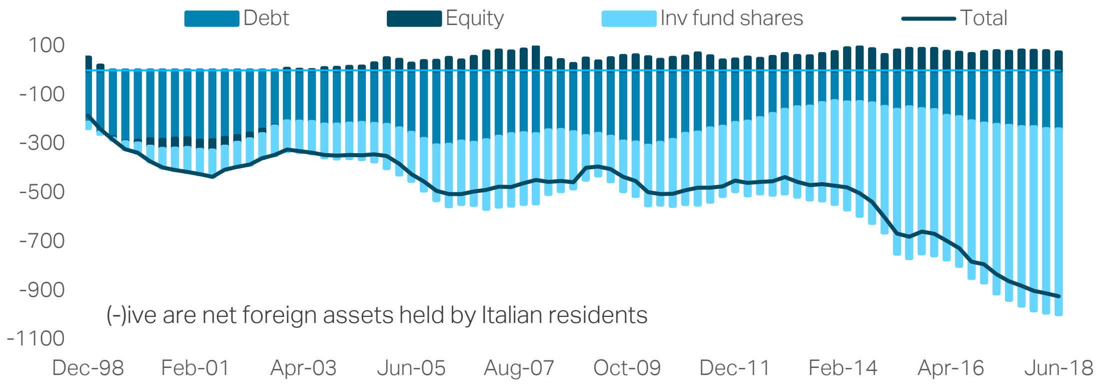
Italy's growth seems to be falling back on (or even somewhat below) its potential level. The GDP print for Q3 was virtually zero and, although a rebound is in the cards, a slowdown seems to be underway. However, the pace of this reversion to potential has been faster than expected. Many factors, including sector-specific ones (e.g. new emission limits in the car industry), have contributed to this outcome. Germany slowing at the tune of -0.2% in Q3 is certainly a reflection of those dynamics and the strong trade ties with Italy (especially as the car industry is concerned) don't bode well for the future of Italian growth.

The service PMI followed the manufacturing index falling sharply to 49.3 and missing expectations that still put it above 50.0. The message that the domestic side of the economy is also slowing a tad now is loud and clear. While the rise in energy cost is certainly a drag (although poised to fade with oil price strength) on real wages and consumption, part of this softness might also be due to the shift from permanent to temporary hiring occurred in the past four months, and especially since the government took action to make harder to fire or dismiss workers ("Decreto Dignità"). The extent to which all these weaknesses are denting Italy's growth will depend on the impact they have on capex. The divergence between business sentiment (falling below long-term average) and hiring expectations (ticking up again) might signal the intention by firm to resort to the old labour-for-capital substitution strategy to preserve margins.

Finally, in the face of a contraction in export and increasing capital outflows from Italian assets by both foreign and domestic investors we can't rule out that, given the country risk premium is expected to remain elevated or even rise from current levels, Italy might find itself sooner rather than later with some financing gap on the balance of payment. In other words, both demand deflation (i.e. lower imports) and/or a debt crisis look possible going forward.

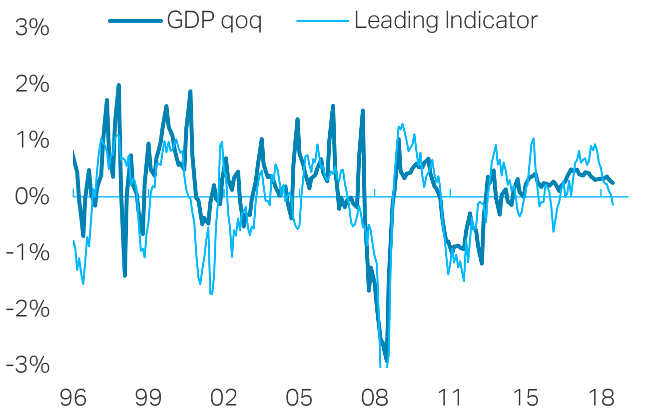
Domestic outflows are as hard to reverse as foreign ones

NIIP, private sector ex MFIs, EURbn



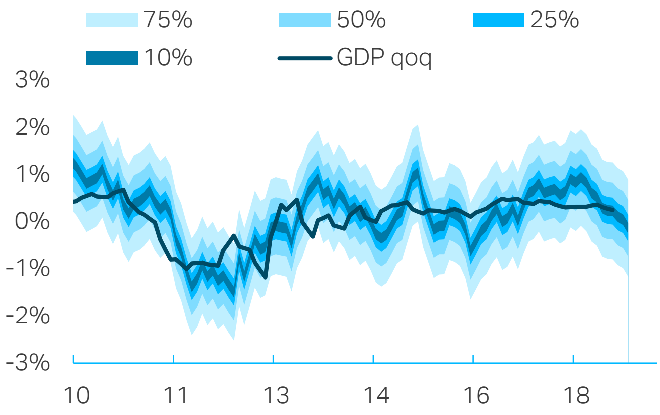
Source: Bank of Italy, Datastream, TS Lombard

The LI edges lower



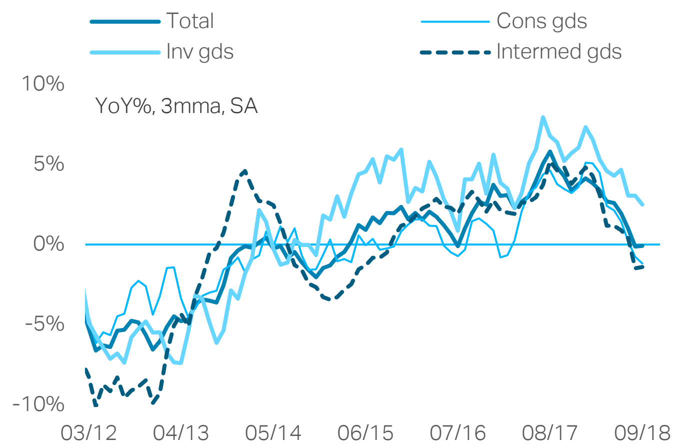
Source: Datastream, TS Lombard

LI confidence intervals



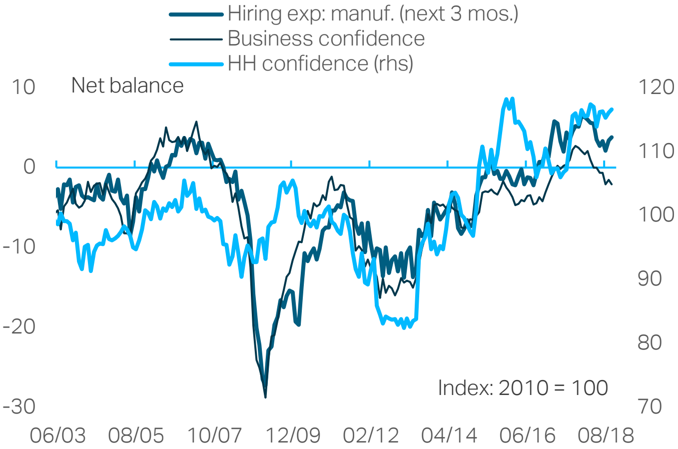
Source: TS Lombard estimates

Still weak industrial production



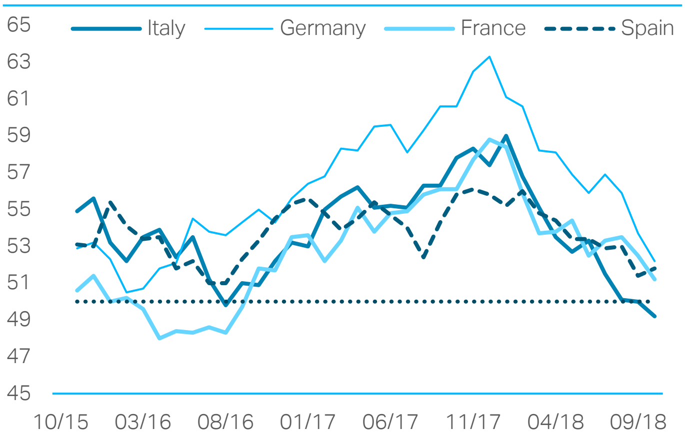
Source: ISTAT, Datastream, TS Lombard

Business sentiment sinks



Source: ISTAT, Datastream, TS Lombard

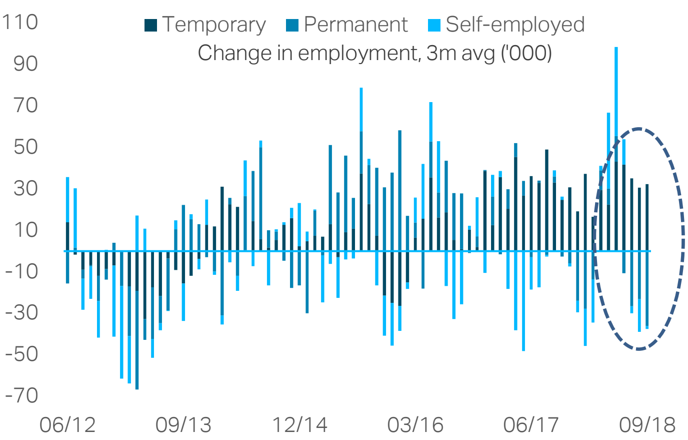
Italian manufacturing PMI enters contraction territory



Source: Markit, Datastream, TS Lombard

Permanent employment falls

Employment by contract type



Source: ISTAT, Datastream, TS Lombard

SPAIN

Davide Oneglia

Strong labour market and domestic demand

The Spanish LI softens but remains at high levels. Labour continues to be the top limiting factor for businesses, wages rise. According to Q3 GDP details, net exports are again a drag, but consumption and capex are buoyant.

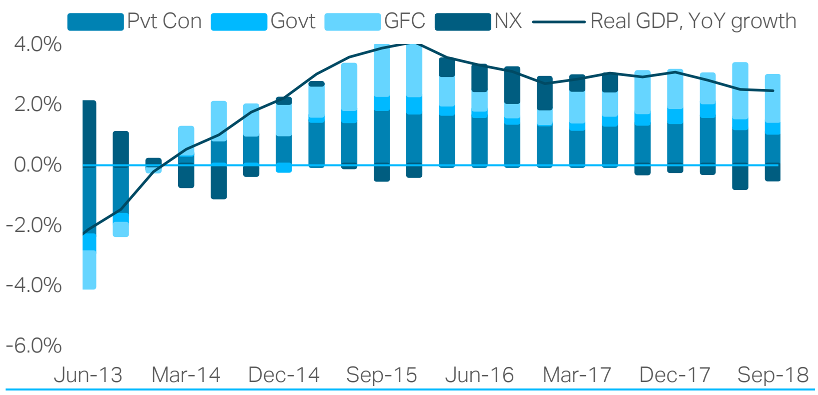
As we anticipated last month, GDP details for Q3 show that net exports for Spain has been weak over the past quarter and it's likely to remain so for longer. Although the net balance has reduced, we can see that this was mostly the result of the contribution for imports falling more in line with exports, although by less. So, this is not a sign of easing export pressures yet.

Moreover, looking at the breakdown between EA and non-EA foreign industrial orders from Spain, it turns out the intra-EA foreign orders have been suffering more than the non-EA ones over Q3 (data are until September). Therefore, while the possibility that China might be supporting trade with Europe to isolate the US from its potential EA allies (as we suggested last month) is still valid, we take notice that EA weakness (and especially the developments in the car industry, which is important for Spanish export) must have played a role.

On the flip side, data are quite clear about domestic demand strength, and especially firm's capex, which has continued to grow at a brisk pace. PMIs seem to reflect a similar domestic-versus-foreign demand divergence, as the service PMI ticks up more decisively than the manufacturing one. Meanwhile, labour remains by far the most relevant factor limiting production. Indeed, as unemployment (although still at high levels) continues to normalise—especially in its composition (see bottom-right chart overleaf)—wages keep their upward path.

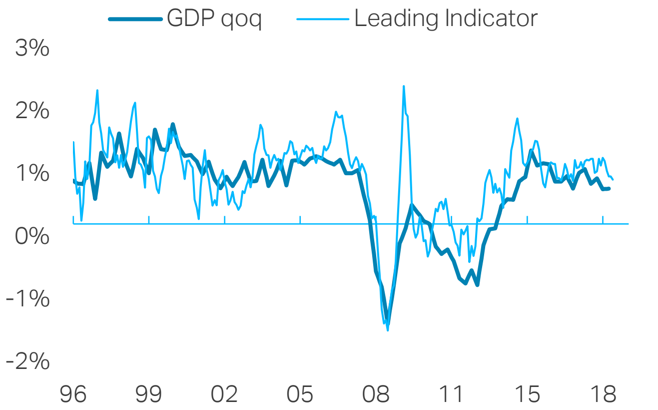
Finally, last month we discussed the weakness of Spanish banks, and consequently of the whole Spanish stock market, as Argentina's inflation hit profits, uncertainty around the market reaction to Brazil's general election weighed on Santander's valuations, and the threat of large pay-outs due to changes in mortgage regulations loomed. However, as uncertainties dissipated and quarterly earnings boost energy companies (a big sector for the IBEX), we take a more positive stance on Spanish equities in our latest Asset Allocation.

Spanish GDP: capex resiliance
Percentage points contribution (YoY)



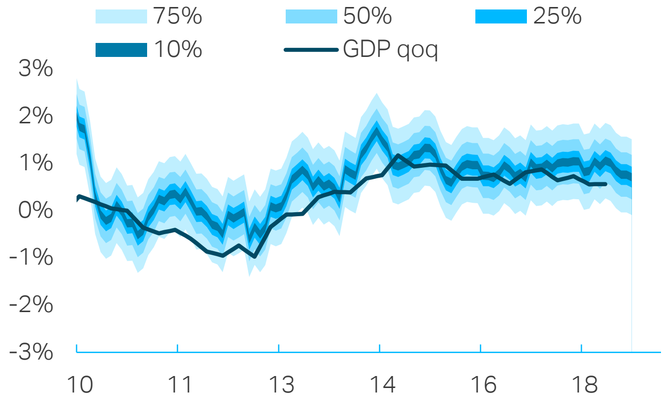
Source: Eurostat, Datastream, TS Lombard

Spanish LI soft but stable



Source: Datastream, TS Lombard

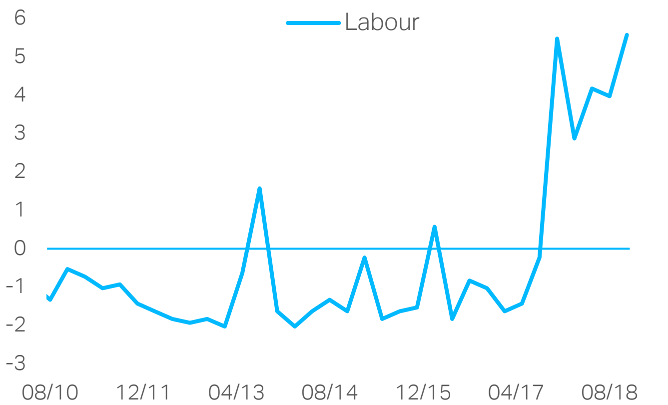
LI confidence intervals



Source: TS Lombard estimates

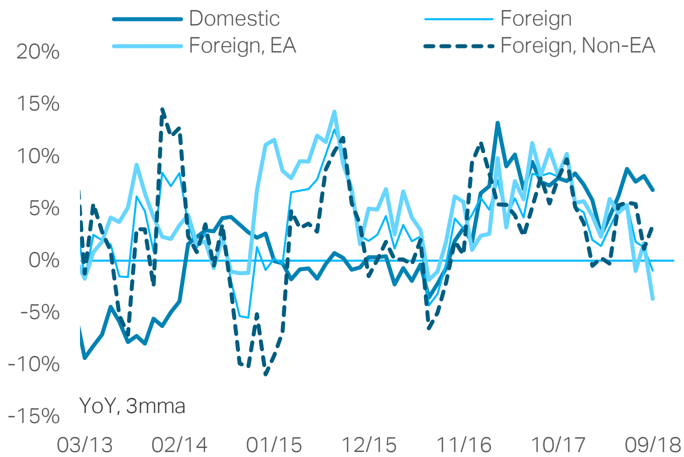
Labour still a constraint

Factors limiting production: diff. from long-term avg.



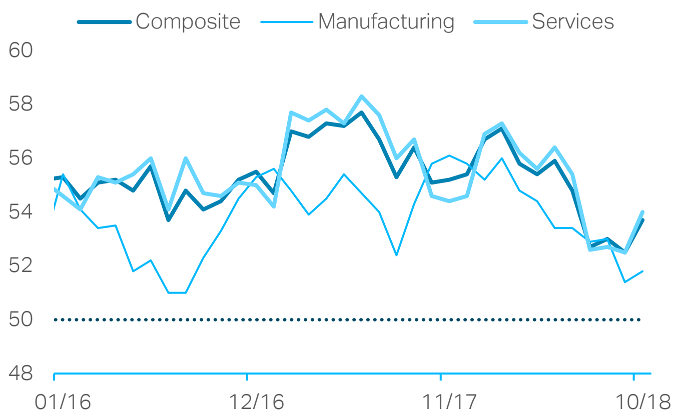
Source: ECB, BLS, Datastream, TS Lombard

EA weakness weighs on orders...



Source: nat. sources, Datastream, TS Lombard

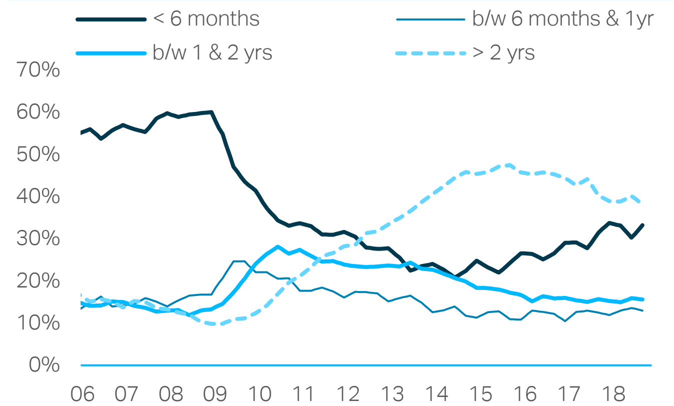
Lowest composite and service PMI since 2016



Source: Markit, Datastream, TS Lombard

Unemployment normalising

Unemployment by duration as % of total



Source: INE, Datastream, TS Lombard

KOREA

Rory Green

Rockets and trade risk ahead

Our LI forecasts deceleration in Q1/19. Softening global trade and slowing investment entail slowing activity through to year end.

All eyes will be on the Xi-Trump meeting next week. The outcome of which could determine the course of global trade, and as such the meeting is a leading indicator for Korean growth in 2019. Regardless of the Xi-Trump outcome, our LI is continuing to forecast sharply slower growth in 2019. We agree, and expect a trade war induced Korean export slowdown in Q1/19, the degree of deceleration will depend on the extent of US-China tariffs.

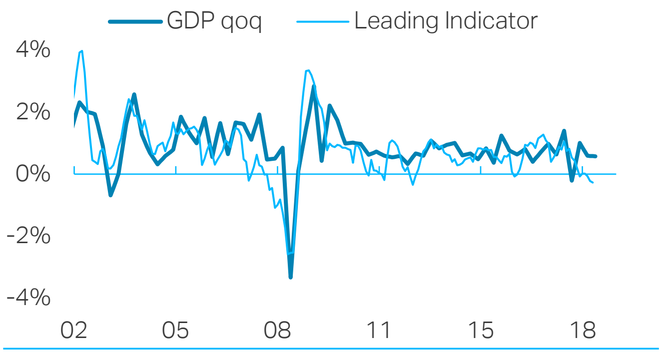
Exports for the remainder of 2018 will continue to drive growth. As expected, trade rebounded last month from the August blip. Preliminary data for the first 20 days of November indicate continued export growth, although the number is down sharply on October growth. Worrying signs are continuing to emerge in the semiconductor sector, which has accounted for 20% of Korean exports in 2018. A slowdown in the sector, exacerbated by the trade war is a risk. We noted, last month that Samsung had cut DRAM prices in the face of falling demand. We listened in to the company's earnings call earlier this month which revealed further company concerns over the future of the chip cycle.

Rocket man risk has resurfaced. As expected, Kim Jong-un has engaged in a controlled escalation of Korean peninsula tension, reportedly testing a weapon for the first time since November 2017. Hitherto, markets have under-priced DPRK related risk, which has allowed Korea's CDS to plummet, reunification-themed stocks to enjoy stellar returns, and prompted credit agencies to downgrade DPRK-related risk. We reiterate discounting the nuclear conundrum is premature, volatility in Korean assets is likely.

The prospect of nuclear war is evidently not conducive to investment. Neither, is the near certainty of minimum wage increases under President Moon. We noted, that minimum wage hikes of 16.9% this year, and 10.9% in 2019, had slowed corporate investment, stalling SME hiring and causing Chaebol to accelerate offshoring plans. The trend is now even clearer, the monthly series for private investment has plummeted and the quarterly gross fixed capital formation rate is equally poor at -6.5% yoy, led by corporate investment at -7.72% yoy (base effects, after exceptionally strong investment in 2017, are exaggerating the slow down). President Moon has shown every inclination to double down on "income led growth" policies, increasing the minimum wage a further 32% from 2018 levels. The appointment of a new finance minister promises more of the same from the Blue House, we expect corporates to respond with further reductions to investment through 2019.

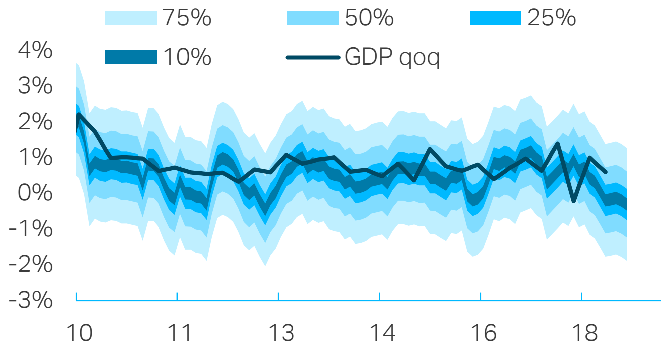
The BOK will meet for its final monetary policy meeting of 2018 next Friday (30/11/18). A few hours later Trump and Xi gather at the G20 summit. The BOK is unlikely to hike before receiving a clearer indication on the trade war, possibly to come at the latter meeting. Last month, the bank finally broke from government rhetoric and admitted the economy was facing major headwinds, revising its forecast for 2018 GDP growth down 0.2 percentage points to 2.7%. The revision and more realistic economic assessment coming from the bank delay a prospective hike to late December or Q1/19. A hawkish move is contingent on domestic employment and global trade.

LI down on trade and employment



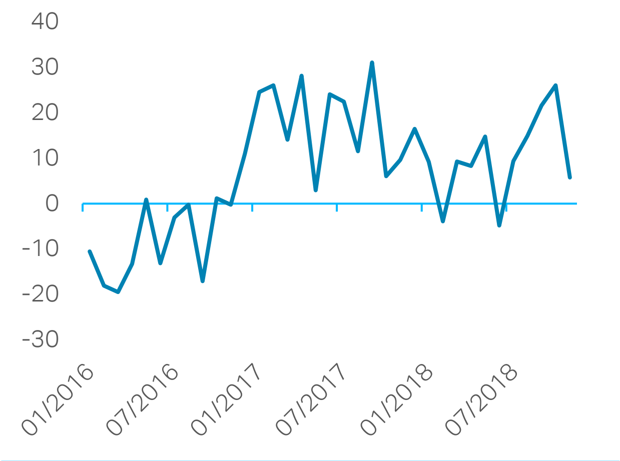
Source: Datastream, TS Lombard

LI confidence intervals



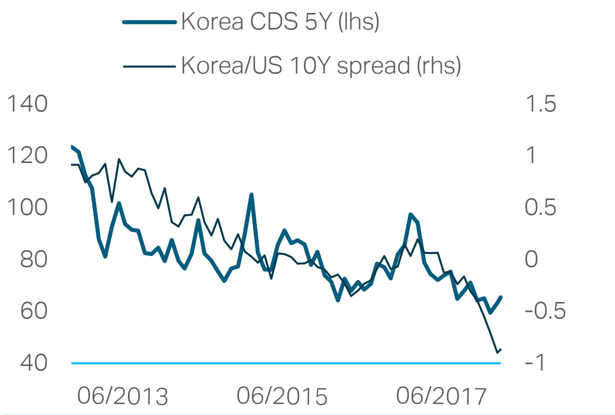
Source: TS Lombard estimates

First 20 day export growth yoy %



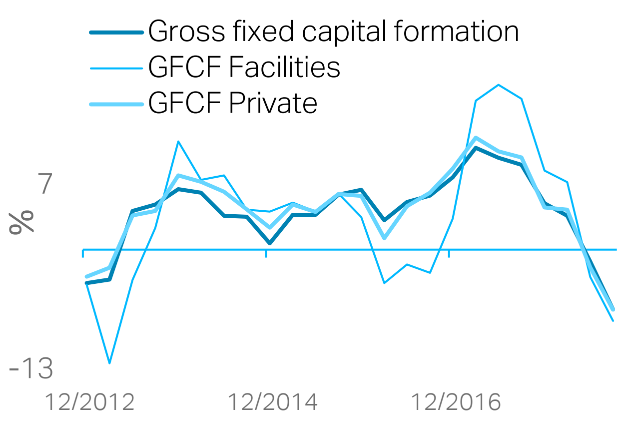
Sources: CEIC, TS Lombard

KR/US spread and CDS at historic lows



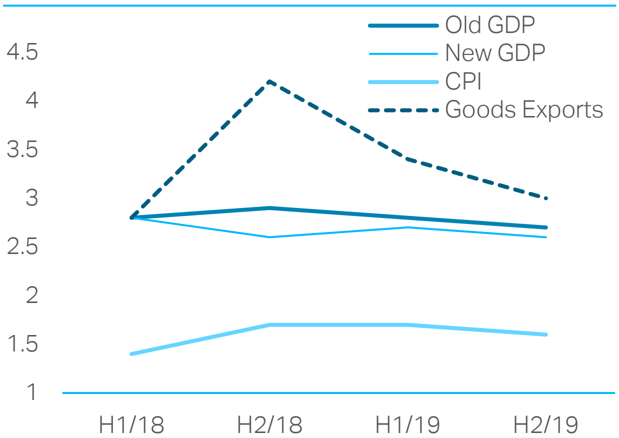
Sources: CEIC, TS Lombard.

Corporate investment leads broader decline (%, yoy)



Sources: CEIC, TS Lombard.

BOK adjusts forecasts ... down (yoy, %)



Sources: BOK, TS Lombard

INDIA

Shumita Deveshwar

RBI-government spat a signal of sluggish growth

The Indian economy is showing signs of recovery, but indicators remain volatile and not fast enough to satisfy a government that faces an election in less than 6 months from now. The easing in crude oil prices has helped reduce some of the macroeconomic risks, but core inflation remains elevated and fiscal slippage is still likely.

The acrimony between the Reserve Bank of India and the government that has dominated financial news over the past month appears to have been diffused – at last for now – with both sides agreeing to some give and take in terms of credit norms for small and medium firms, as well as the capital adequacy rules for the cash-strapped state-run banks. However, a committee will be constituted to consider the more controversial issues, such as the use of central bank reserves and the Prompt Corrective Action that has been imposed on 11 state banks to force them to strengthen their balance sheets before further expanding their loan books.

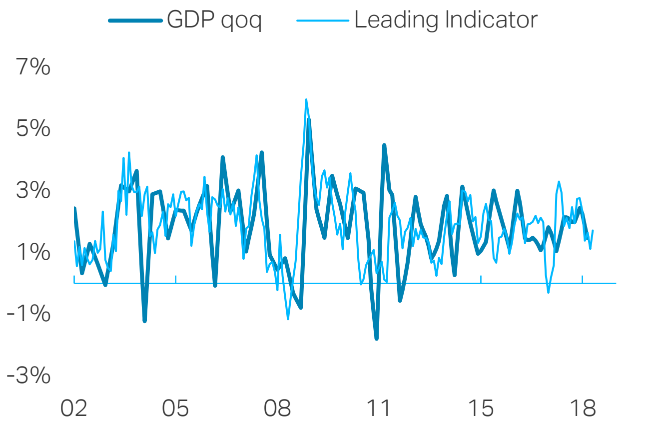
As we highlighted in our 31 October note Costs of the RBI-government spat, a key bone of contention is the use of central bank reserves, with the government asking the RBI to transfer surplus reserves but the latter resisting it. The RBI has been transferring large dividends to the government over the past few years but India's central bank remains among the world's most highly capitalized reserve banks. The government has for a few years now argued that there is no reason why this extra capital should be kept with the RBI but has faced opposition from the current central bank leadership as well as former RBI Governor Raghuram Rajan.

The use of reserves to fund the fiscal deficit has short-term political implications ahead of Prime Minister Narendra Modi's re-election bid in early 2019, as well as longer-term consequences for money supply and inflation. The government had committed to reducing its fiscal deficit to 3.3% of GDP in FY19 from 3.5% in the previous year, but it may find it difficult to meet that target due to a cut in excise duties on fuel as well as lower-than-estimated GST revenues (despite a jump in the October collections).

The budget gap in 1H/FY19 was equal to 95.3% of the full year target compared with 91.3% of the full year target during the corresponding year-ago period and 83.9% in 1H/FY7. But the RBI is not only concerned about the central government's fiscal deficit but also the combined budget gaps of the centre and the state governments

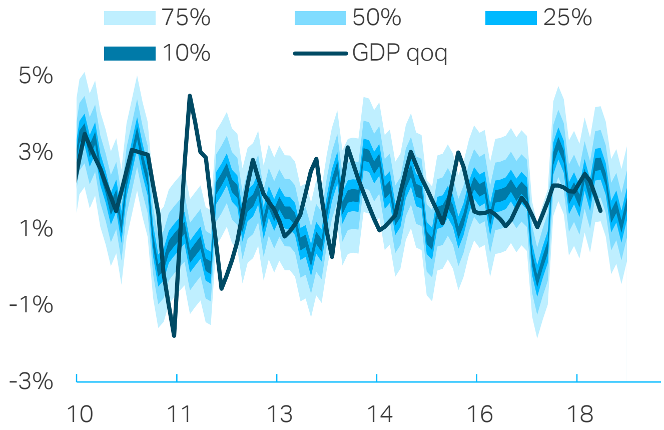
Despite the surprisingly low headline CPI inflation number, the RBI has held on to a tight monetary policy due to elevated core inflation. The latest data for October showed that the headline number remained below the RBI's 4% inflation target for the third consecutive month, and at 3.3% yoy it undershot analysts' estimates as well. However, core inflation rose above 6% yoy in October after a brief dip to just below that level. The RBI had changed its monetary policy stance from 'neutral' to 'calibrated tightening' in its October review, and although it will be hard to justify a rate hike at its December review (as earlier expected), we believe it will hold the policy repo rate at 6.5% due to high core inflation.

LI reflects moderate recovery



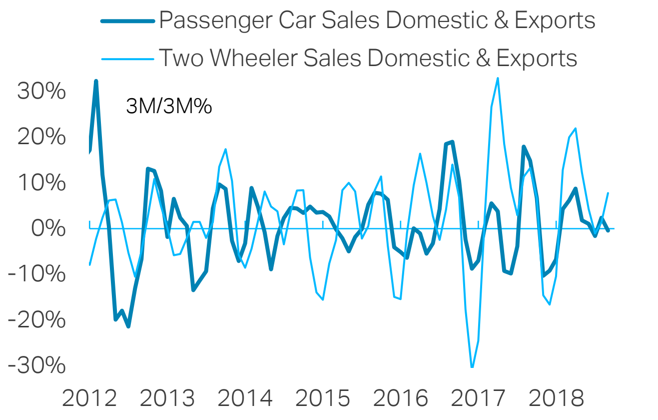
Source: Datastream, TS Lombard

LI confidence intervals



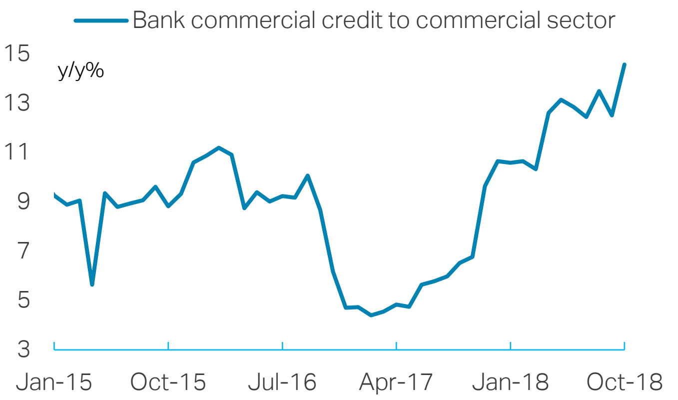
Source: TS Lombard estimates

Consumer demand picks up



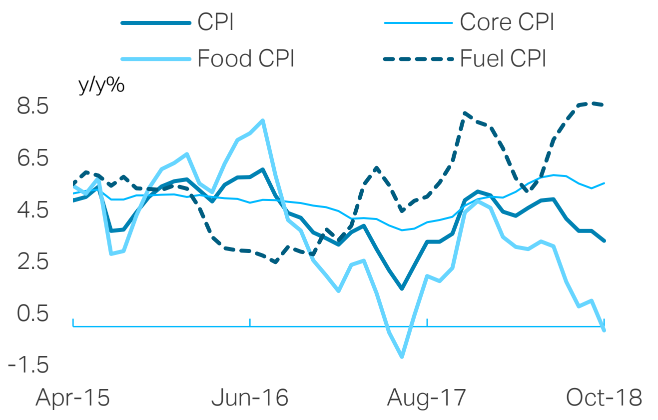
Source: Datastream, TS Lombard

Credit growth up on still low base



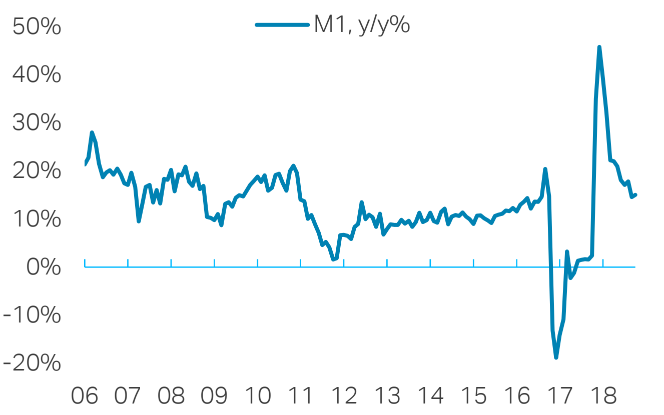
Source: Bloomberg, TS Lombard

Food prices mask inflation



Source: Bloomberg, TS Lombard

Money supply normalises



Source: Bloomberg, TS Lombard

AUSTRALIA

Konstantinos Venetis

Household incomes stuck in low gear

Solid strength in employment has failed to translate into faster wage growth, keeping the RBA on hold for as far as the eye can see.

Our LI has ticked down. The labour market had another strong month in October, lifting consumer confidence to levels last seen in July. Employment rose by 32.8k, up 2.5% in annual terms, driven by full-time jobs (+42.3k). Monthly trend employment is running at 25k, outpacing trend growth in the labour force (17k). The combination of solid job creation and steady participation has driven the unemployment rate down to 5%. In New South Wales and Victoria, Australia's two largest states, the jobless rate has dropped to around 4.5%. This has failed to translate into faster wage growth, however, pointing to persistent slack in the labour market. Quarterly wage growth was unchanged at 0.6% in Q3 (2.3% Y/Y); coupled with a thinning savings buffer and a negative wealth effect from falling house prices, this constitutes a serious headwind for household spending. Retail sales in volume terms slowed to 0.2% Q/Q in the third quarter, less than half the ABS's estimate of trend.

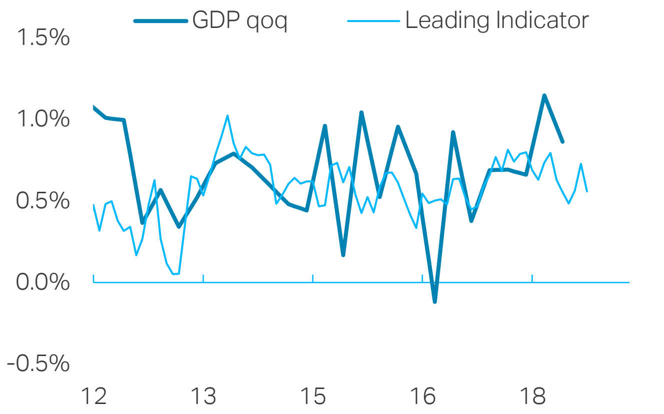
Job creation strong but slowing
3m MA

Source: CEIC, TS Lombard

The continued slide in NAB's monthly business indices points to soft business sentiment. The manufacturing PMI rose for the third consecutive month in October (54.5), but weakness in services (51.7) is keeping the composite index down (52.0). After three strong quarters, export momentum seems to be cooling. Annual growth in services is looking toppish and this year's recovery in goods is starting to lose steam. Annual growth in imports has held steady but September's 2.4% Y/Y decline in the capital goods segment could be a warning sign. Imports have plateaued in H2, boosting the trade surplus.

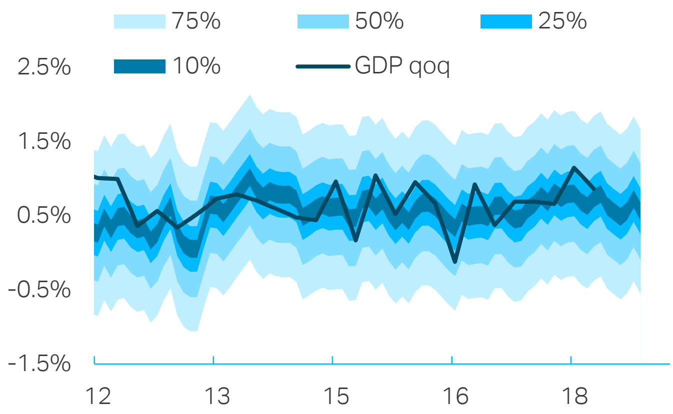
With real household incomes stagnating; inflationary pressures subdued (annual underlying inflation edged lower to 1.8% in Q3); the property market in correction mode; private credit growth stuck in low gear amid tightening lending standards; and trade war risks elevated, the RBA remains firmly in wait-and-see mode.

LI lacking impetus



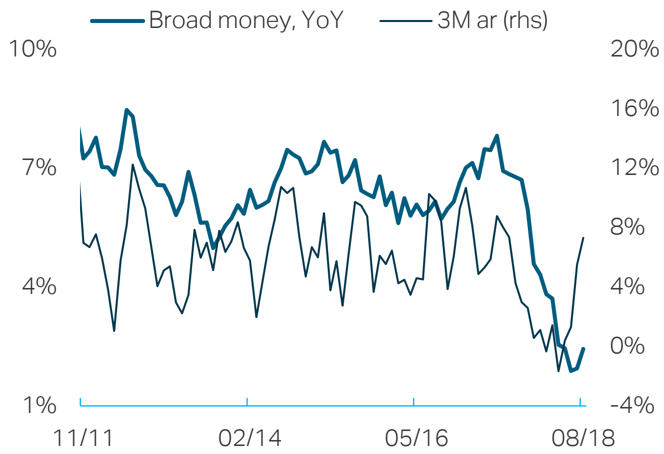
Source: Datastream, TS Lombard

LI confidence intervals



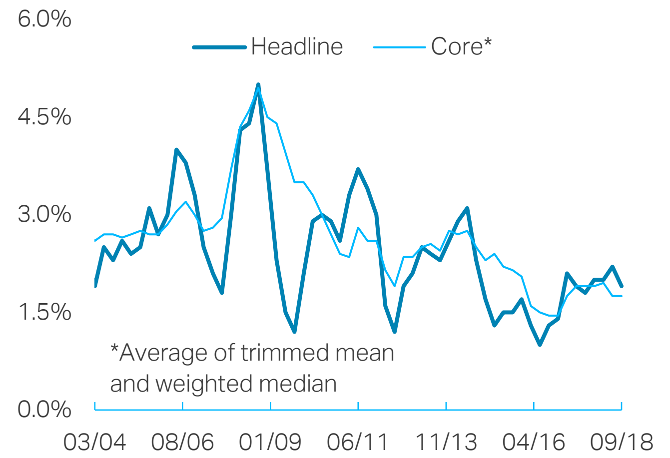
Source: TS Lombard estimates

Money growth stabilising



Source: CEIC, TS Lombard

Inflation steady in Q3



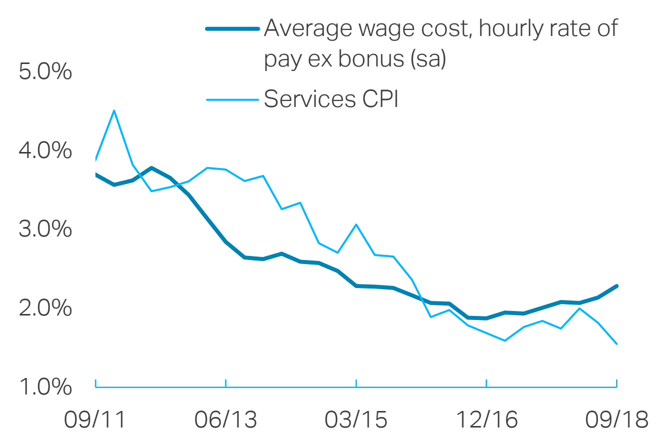
Source: CEIC, TS Lombard

Underemployment points to slack

Source: CEIC, TS Lombard

Wages bottoming out

YoY changes



Source: Bloomberg, TS Lombard

BRAZIL

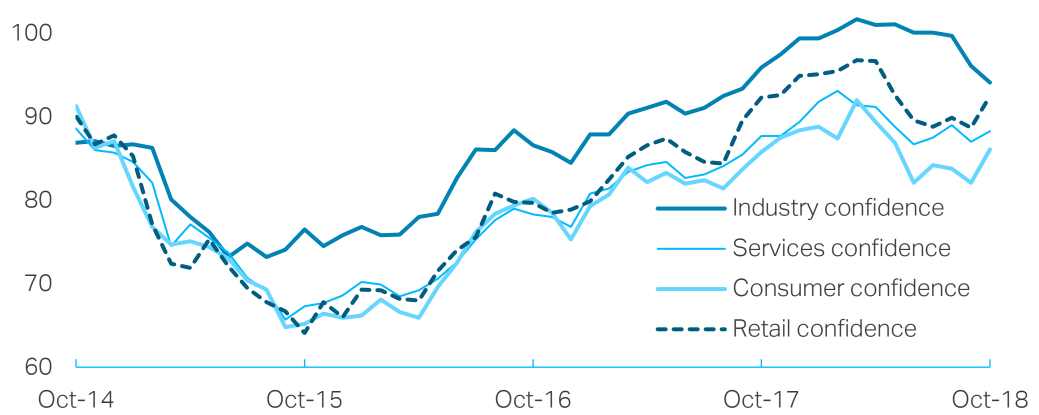
Wilson Ferrarezi

Economy sends mixed signals

Our LI eroded further this month. Yet confidence levels improved at the margin post-election. Confidence should maintain an upward trend amid falling uncertainty. Yet, stronger activity recovery remains limited by still weak labour market indicators.

Most confidence levels recovered in October, according to Fundação Getulio Vargas, after remaining subdued during the pre-election period. Consumer confidence rose 4.9% mom/sa in the month, from -2.0% in September, retail confidence rose 4.3% mom/sa, from -1.3% previously, and services confidence posted a 1.5% increase in mom/sa terms, from -2.2% in August. Industry confidence, on the other hand, posted the third consecutive mom/sa decline at -2.1%, from -3.6% in September. Yet, other leading indicators for industrial production (IP) pointed up in the month. Auto production, for instance, rose 4.4% mom/sa in October, according to the Auto Producers' Association (ANFAVEA), which could signal a stronger IP in the October print, in contrast with the 1.3% mom/sa decline in September.

Most confidence levels increase at the margin

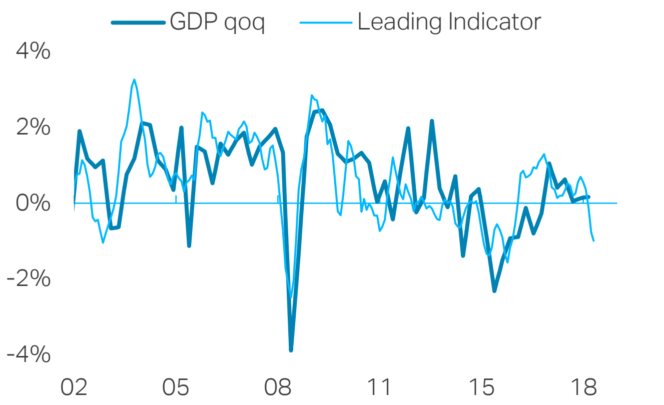


Source: FGV, TS Lombard

Confidence levels should maintain an upward trend in coming months, after the appointment of a market-friendly, reform-oriented economic team by incoming President Bolsonaro. Yet, a stronger rebound of economic activity hinges on improvements in labour market indicators. The three-month unemployment rate to September remains historically high at 11.9%, vs 12.1% in August. In October, 57,700 net formal jobs were created vs 137,300 in September, reaching 356,000 net jobs created on a 12-month basis, from 374,900 a month earlier.

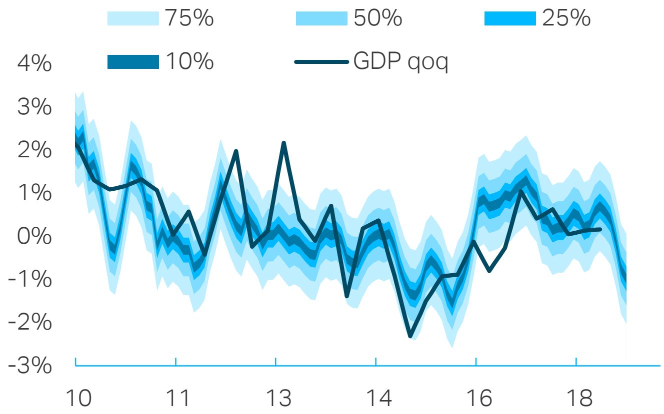
Overall, economic activity level slowed in September amid electoral uncertainty. The Brazilian Central Bank's (BCB) monthly IBC-Br economic index, a proxy of GDP, declined to 0.7% yoy in the month, from 2.3% previously, while it fell 0.1% in mom/sa terms, from 0.5%. Meanwhile, IPCA inflation increased 0.45% mom in October, from 0.48% mom in September, reaching 4.56% yoy, vs 4.53% yoy previously.

LI edges down



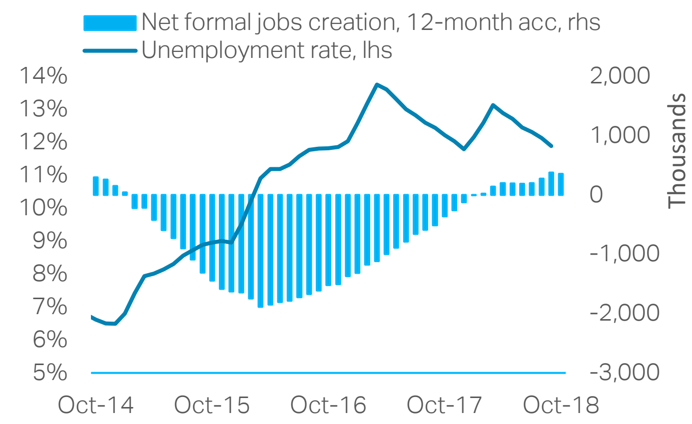
Source: Datastream, TS Lombard

LI confidence intervals



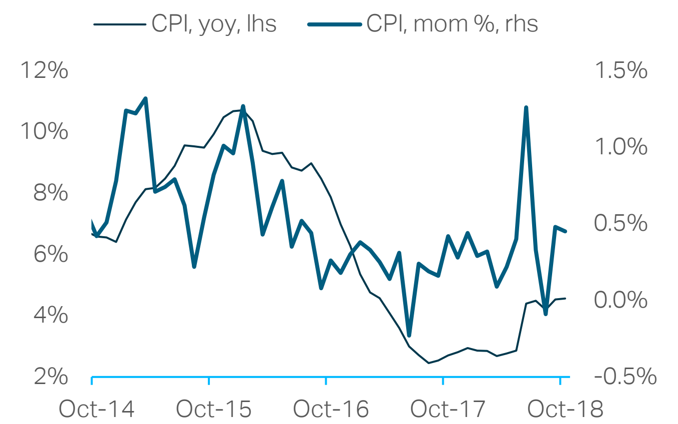
Source: TS Lombard estimates

Declining but high unemployment



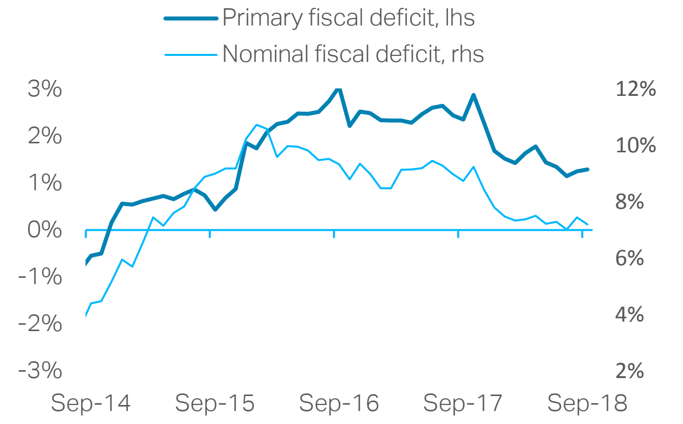
Source: IBGE, TS Lombard

Inflation flat at the margin



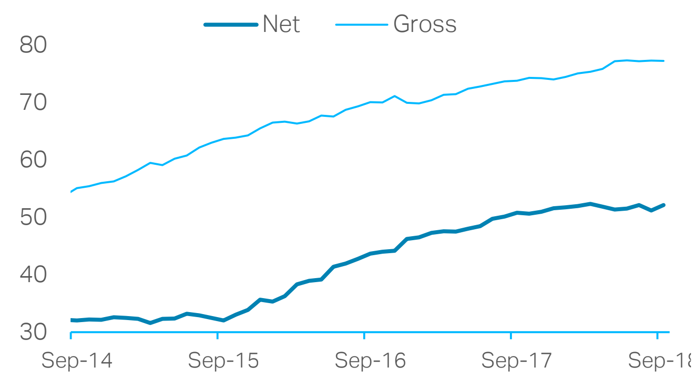
Source: IBGE, TS Lombard

Primary deficit rises at the margin



Source: BCB, TS Lombard

Public debt still rising - % of GDP



Source: BCB, TS Lombard

MEXICO

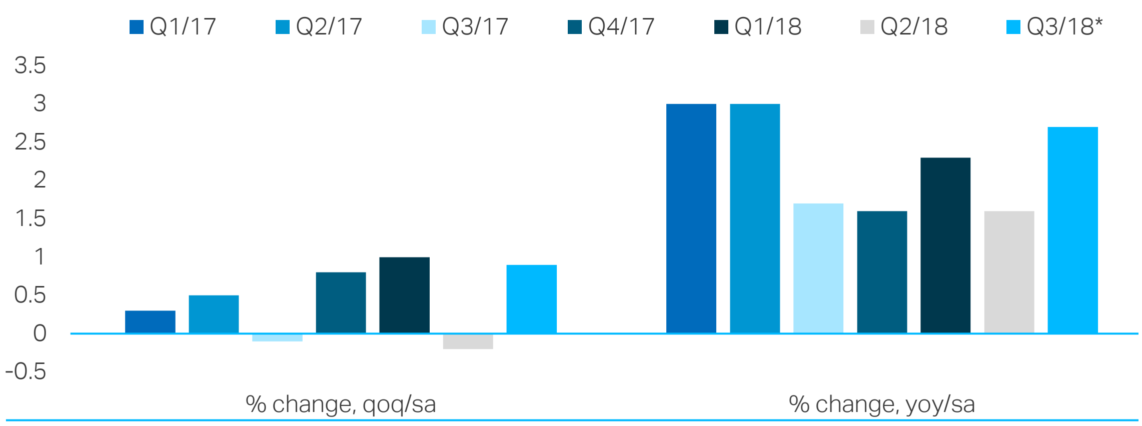
Grace Fan

Clouds over the economy despite Q3 recovery

The LI remains soft. Market confidence has been rattled recently, following contentious moves by the incoming leftist President-elect.

After contracting slightly in Q2, the Mexican economy got some good news in Q3, with GDP growth rebounding to 0.9% qoq/sa and growing 2.7% yoy/sa, according to preliminary estimates from the country's statistics bureau INEGI. The recovery was aided by a big spike in consumer confidence after the July presidential election, in which leftist populist Andrés Manuel López Obrador (AMLO) won a landslide victory. Stronger industrial output after a preliminary deal on NAFTA 2.0 (USMCA) was reached with the US in late August also helped quarterly results.

Mexico's GDP

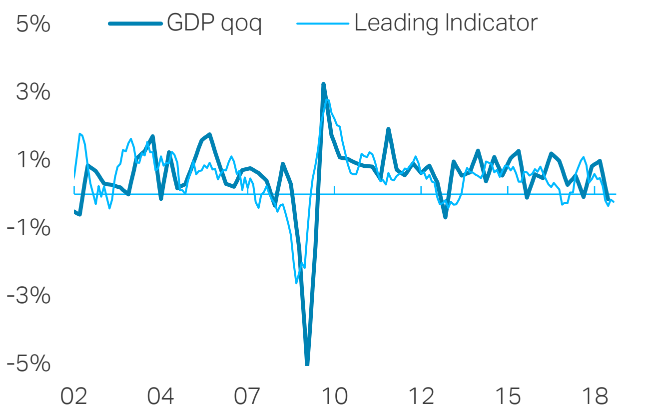


*Preliminary estimates.
Source: INEGI.

Looking ahead, although average 2018 GDP estimates remain stable at 2.1%, investor sentiment has markedly soured on Latin America's second-largest economy in recent weeks, following the cancellation of the partly built USD13 billion Mexico City airport by AMLO on 29 October, after a controversial public consultation and voluntary vote in which just 1% of the electorate participated. More shocks have followed, as legislators in the President-elect's Morena party have proposed sharply curbing bank fees as well as requiring the consent of indigenous communities before mining concessions are granted. Another big point of concern is AMLO's planned use of more public consultations to help his government ratify key decisions.

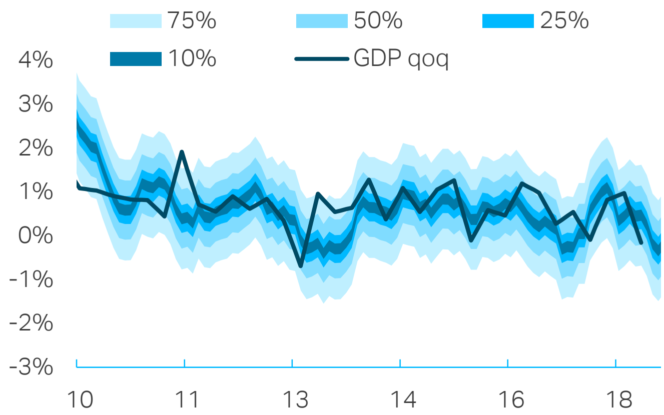
With growing worries about AMLO's future policies, the outlook for 2019 has naturally begun to dim as well. According to the latest Citibanamex investor survey, the average 2019 GDP forecast has edged down to 1.9%, down 0.1pp from the previous survey, while the peso is expected to end next year at MXN20/USD vs MXN19.35/USD in the previous forecast. All eyes are now on the upcoming 2019 budget bill, which could help to calm the market if it appears fiscally credible or to spook investors further if it appears unrealistic. The budget bill must be presented no later than 15 December and voted on in the legislature before yearend.

LI drops further



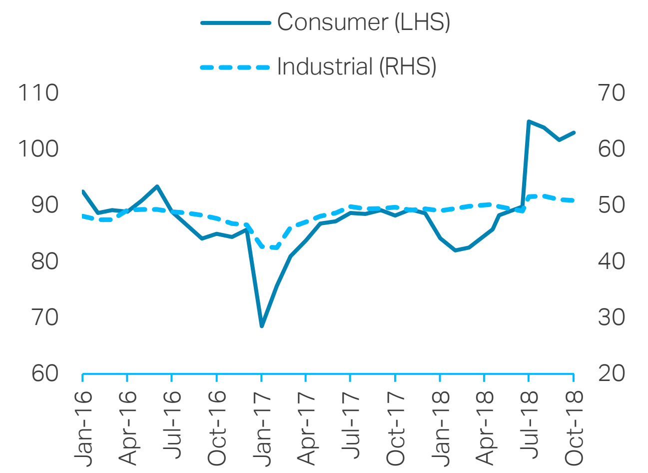
Source: TS Lombard estimates

LI confidence intervals



Source: TS Lombard estimates

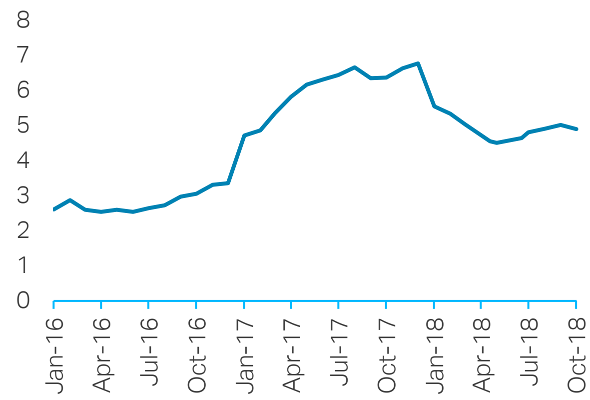
Consumer vs industrial confidence



Source: INEGI.

CPI has levelled off but is still well above the target of 3%

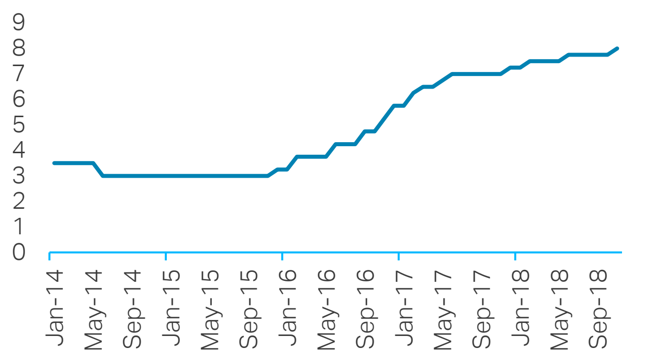
%



Source: INEGI.

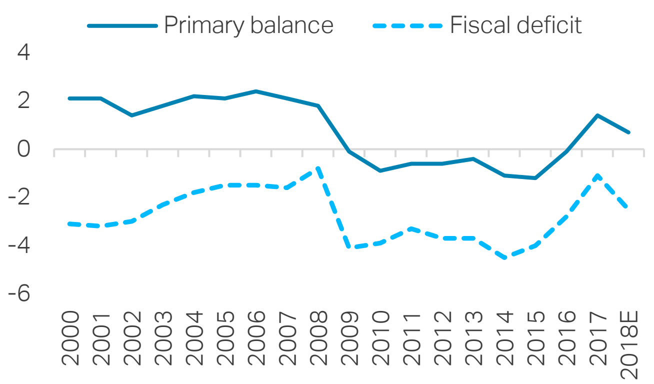
Key interest rate has risen to nearly 10-year highs of 8%

%



Source: Banxico.

All eyes on the fiscal outlook



Source: Finance Ministry.

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