



Global Leading Indicators

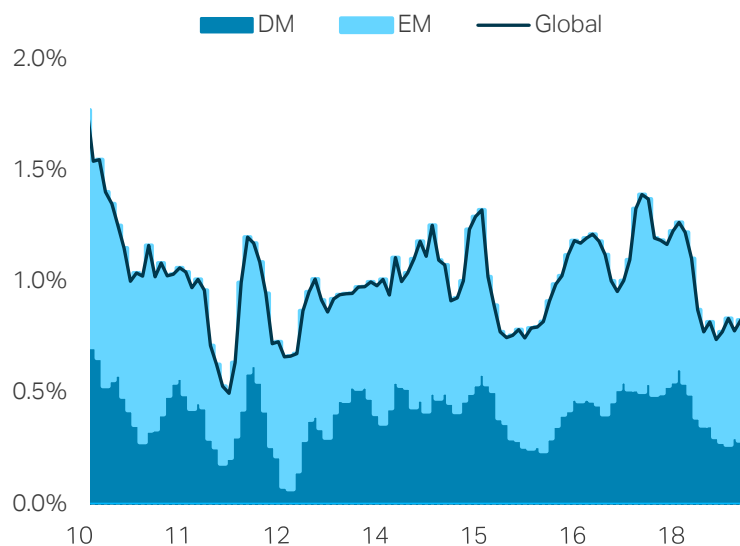
RE-SYNCHRONISING LOWER

Konstantinos Venetis / Davide Oneglia

- World economy recoupling lower as the US and China 'trade places'
- China gradually turning the corner as the slowdown reaches US shores
- Tentative signs of stabilisation point to better macro momentum in H2
- Fed easing and Beijing stimulus could extend the global cycle
- But those hoping for a swift 2017-style revival are likely to be disappointed

Tentative signs of stabilisation

Global Leading Indicator and components



This month we are launching a new, more concise format for Global Leading Indicators. The 'World' section has been expanded; and our country-specific pages have been replaced with a chartbook drawing on a suite of high-frequency indicators that help us take the temperature of the global economy.

Re-synchronising lower

The world economy is recoupling at slower rates of growth, with the US expansion weakening while China is gradually turning the corner. Forward-looking indicators tentatively point to better macro momentum in H2 2019. But those expecting a swift 2017-type revival are likely to be disappointed.

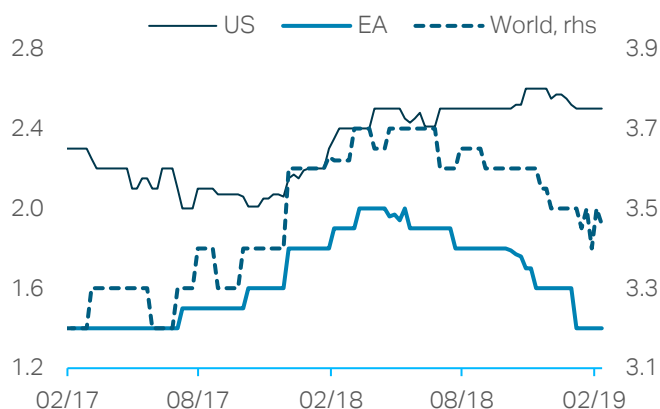
Risk assets have come a long way over the last couple of months. Stocks have risen pretty much in a straight line from the winter lows, despite a string of data pointing to slowing global growth. The rebound has been driven by three factors. The Fed made a dovish about-turn in January, quelling fears of a monetary policy mistake that had spooked financial markets in Q4, culminating in December's sell-off. Chinese policymakers are pursuing a looser policy mix, with growth gradually taking priority over deleveraging objectives. Finally, there have been signs of de-escalation on the US-China trade war front.

This is all good news. But have investors turned too optimistic, or is the market correctly discounting brighter days ahead? The answer probably lies somewhere in the middle. As we argue below, the global economy is not out of the woods yet, and things are likely to get worse (or stay bad) before they get better. But there are also tentative signs of stabilisation that point to improving macro momentum in the second half of the year. Still, those hoping for a repeat of 2016/17 – when policy shifts in China and the US set the stage for global synchronised reflation – may be in for disappointment. This time round both the Fed and the PBoC are playing defence, not setting up a Goldilocks scenario.

Beijing is in 'measured' easing mode, at least for the time being. We expect the nascent pick-up in Chinese credit growth to be weaker than in the previous easing cycle, reaching a 14.5% annual rate by year-end. Back in 2015/16, total credit growth accelerated from just under 13% to a little over 20% in the space of 18 months. Crucially, the large commercial banks remain cautious about

Re-synchronising lower

Consensus annual real GDP growth estimates for 2019



Source: Bloomberg, TS Lombard

Still early days

Per cent



Source: Bloomberg, TS Lombard

lending to the private sector, opting to hoard liquidity against a backdrop of deflationary headwinds that are fuelling concerns about business profitability and creditworthiness. 2019 is also shaping up to be the year when the US and China – the main locomotives of the global economy – ‘swap’ places, with the US expansion cooling as China gradually improves. It seems hard to envisage a swift global economic revival while this transition is underway. In short, initial conditions matter: the world economy is recoupling lower, not poised for a synchronised upturn as it was three years ago.

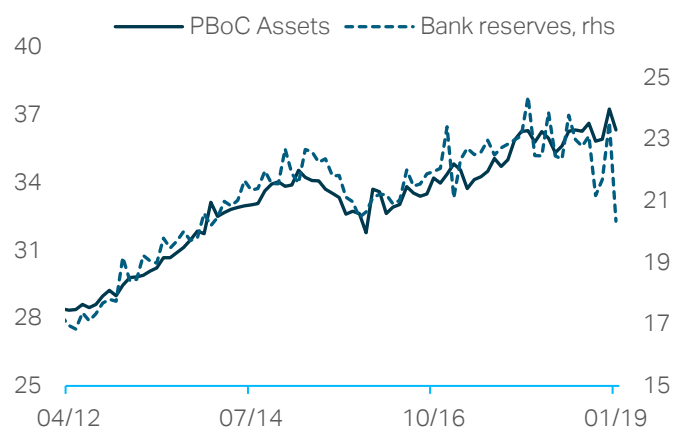
Comparing today’s situation to that in 2016 is instructive. Back then, like now, the Fed switched to a more pragmatic stance amid pronounced weakness in financial asset markets. It toned down its hawkish outlook and refrained from hiking rates until December 2016. Perhaps more importantly, Beijing launched a large-scale fiscal stimulus, triggering a powerful wave of global restocking that created a virtuous circle of investment spending, trade and industrial activity. Commodities and EM assets bottomed out early on in anticipation of the manufacturing upswing that culminated in late 2017.

Over the course of 2018, it became increasingly evident that the world economy was starting to lose steam. The lift in business spending faded in tandem with a tired inventory cycle and inevitably took world trade down with it. Heightened uncertainty surrounding Trump’s trade tactics did not help, sapping confidence and leading firms to put capex plans on ice. The biggest headwind came from China: a combination of slowing demand and sustained CNY depreciation that spread the pain to the rest of the world. In EMs, tighter global liquidity conditions (a mix of dollar strength, a cumulative 200bps of Fed rate hikes and Fed QT) and rising oil prices compounded the pressure. So it is no coincidence that the countries that have suffered the most – among EMs and DMs alike – are those with a high dependence on exports and manufacturing.

With exports making up almost half of GDP, the downswing in external demand has kept the German economy on the back foot. Brexit-induced weakness has generated additional headwinds in the euro area, forcing economic surprise indices and consensus growth forecasts sharply lower since mid-2018. The same is true of Latin America, where industrial production remains firmly in contraction. North Asia’s manufacturers have felt the impact of slowing Chinese demand first hand. Japanese exports – over half of which are shipped to the rest of Asia – recovered in Q4 after a 1.4% quarterly drop in Q3, but this still translated into a disappointingly low 0.1% average quarterly growth rate in 2018. Asian export prices have come under pressure

Chinese banks in defensive mode

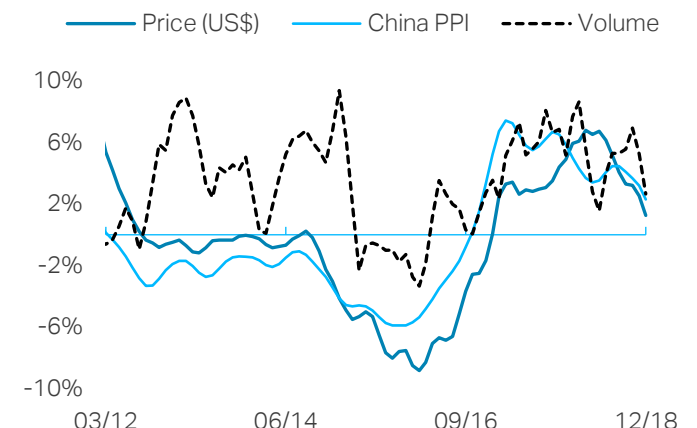
RMB trillion



Source: Bloomberg, TS Lombard

Reversion to mean

Asian export indices and China PPI, YoY (3m MA)

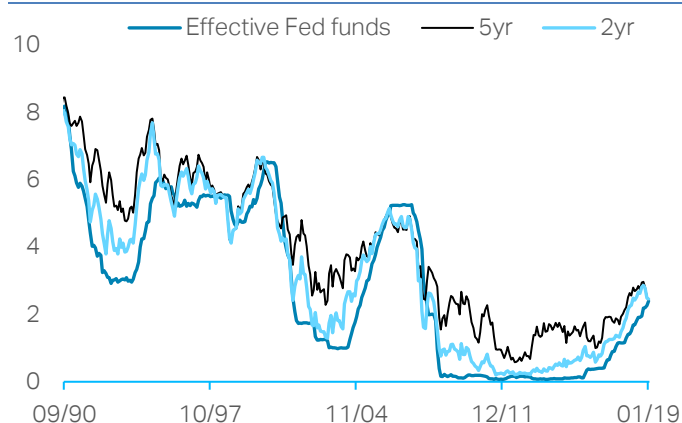


Source: Bloomberg, TS Lombard

from the combination of soft demand, China-driven PPI disinflation and tougher funding conditions due to the strong dollar.

Discovering 'neutral'

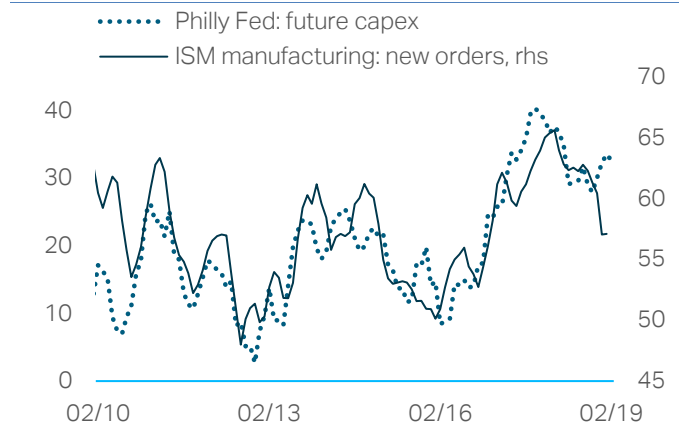
Percent



Source: Bloomberg, TS Lombard

Down from the highs

Index



Source: Datastream, TS Lombard

Buoyed by fiscal stimulus, the US economy managed to stand out for the best part of 2018. But faltering global macro momentum has finally spread to America, resolving the yawning divergence with the rest of the world. Dollar strength, itself a by-product of US outperformance, has acted as catalyst. To be sure, the US economy remains 'good enough'. It is slowing from above-trend rates of growth and, although metrics such as the Conference Board's Leading Economic Indicator index have soured, the risk of recession looks negligible in the foreseeable future. Yet the engines of the US economy are running low on fuel: businesses are trimming their spending plans; exports are soggy; housing is flat to down; the heavy inventory run-up of H2 2018 foreshadows curtailed output in H1 2019; and a repeat of last year's fiscal stimulus is improbable. Nor is the recent fall in oil prices likely to prove a game-changer for consumption, as it merely restores earlier real income losses that caused household savings to drop in H2. The annual rate of expansion in US real GDP is probably headed below 2% sooner or later.

Indeed, a slew of high-frequency indicators, real and financial, are flashing orange, suggesting a meaningful slowdown in economic activity is already underway – something our US Leading Indicator has been flagging since Q1 2018. New orders for core durable goods have plateaued since the autumn and surveys show a deterioration in manufacturing activity and capex plans. Parts of the front end of the yield curve have inverted and lending standards are tightening. Price pressures are generally weak. Market-implied breakeven inflation rates have retraced somewhat higher, yet this is primarily a reflection of real yields being stuck around last summer's lows.

Worsening US macro dynamics are setting up a Fed policy response, which we expect to come in two phases. First, the FOMC is likely to taper QT – probably at its March meeting – and could launch an 'Operation Untwist', i.e. the Fed would spend the proceeds of Treasury redemptions on short-term paper, in order to ward off the threat of broader yield curve inversion. Second, the Fed could cut the funds rate by a notch when the underlying slowdown becomes more visible, especially if financial market pressures were to mount once again. We think this might happen in the third quarter.

This is also around the time when Beijing's stimulative measures are likely to start kicking in. The combination of Fed easing and a pick-up in Chinese growth therefore has a good chance of

extending the global economic cycle – particularly if trade war risks subside further and if dollar weakness in response to the shift in relative macro strength contributes to easier financial conditions. In that case, 2020 could be a year of re-accelerating global activity that ultimately stokes faster wage growth and a pick-up in inflation. For now, however, global inflation dynamics remain benign. Coupled with a dovish Fed, mild price pressures should allow EM monetary authorities to maintain more of a pro-growth bias. The same goes for the major DM central banks. The ECB and the BoJ are already showing a readiness to rethink the normalisation of monetary policy.

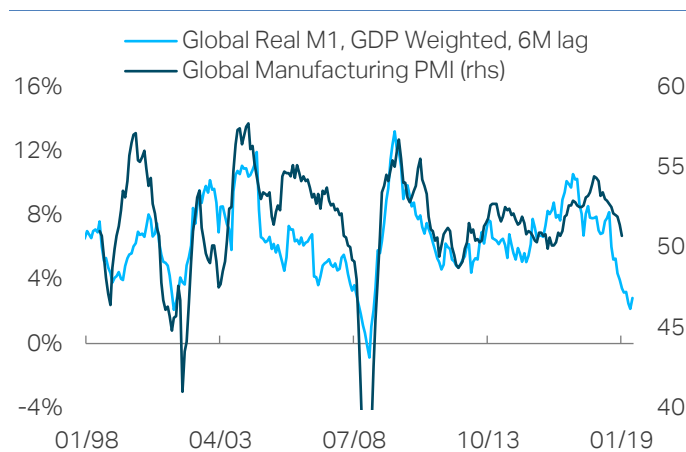
Money growth has collapsed across the board since mid-2018, sending a strong warning signal about the health of the world economy. Our measure of global real M1 growth – which tends to lead the industrial cycle by a couple of quarters – has dropped to levels that, with the exception of the GFC, were last seen in Q4 2000. While a month does not make a trend, the series ticked up in December. If Beijing's easing efforts start bearing fruit over the course of the year, underpinning a re-acceleration in Chinese money growth from current depressed levels, reflationary impulses could pave the way for improvement elsewhere, nurturing a pick-up in global economic activity.

There are already tentative signs of stabilisation in a number of leading indicators we track, as well as in our own Global Leading Indicator.

Emerging market currencies bottomed out in September along with copper and the industrial metals complex, suggesting that H1 2019 could mark the worst of the global slowdown. Chinese equities have been late to the rally in world stocks, losing ground throughout 2018. Interestingly, however, the Shanghai index has outperformed global equities since mid-October and could be discounting a bottom in Chinese real GDP growth in Q2, in line with our expectations. Our Leading Indicator for the euro area remains soft but has stopped deteriorating in recent months. Encouragingly, German car orders posted a strong rebound in January, although the IFO survey still points to fragile sentiment among automakers. Sweden's industrial production and PMI manufacturing index, which are decent leading indicators for the industrial cycle, continue to lack impetus but their decline is showing signs of exhaustion.

Survey data for North Asia's industrialised economies, which tend to sniff out shifts in the global tech cycle relatively early, are showing marginal improvement. Taiwan's manufacturing PMI remains in contraction territory but ticked up in January for the first time since mid-2018. The export order sub-indices of Korea's and China's PMIs are still negative but have stopped falling,

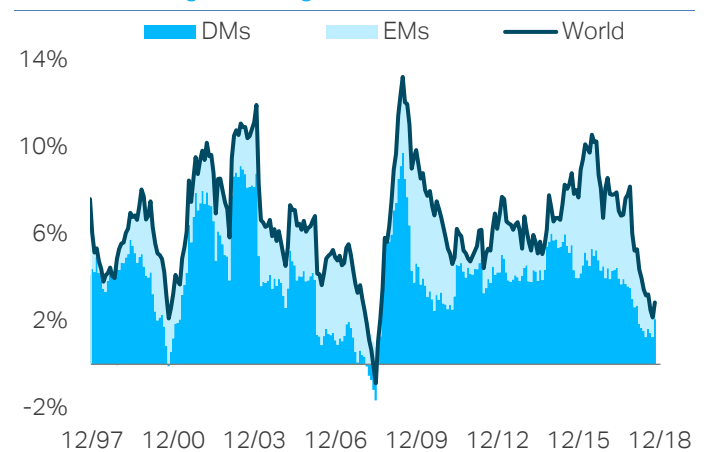
Show me the money



Source: Datastream, TS Lombard

Money growth slowdown is global

Annual rate of growth in global real M1*



Source: Datastream, TS Lombard

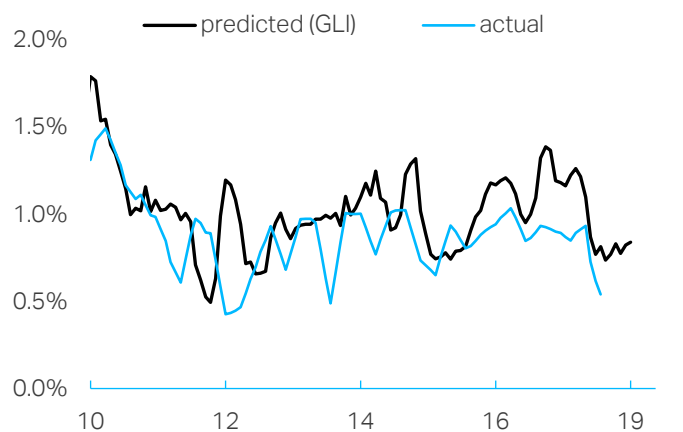
*GDP-weighted

potentially foreshadowing an export recovery in H2. Korean export volumes edged higher in January, while the drop in semiconductor shipments appears to be slowing. In Japan, core machinery orders are showing signs of life after a rough Q4. And while the contraction in machine tool orders may have further to run, history suggests we have probably already seen most of the decline.

Finally, while the services PMI for EMs remains soft it appears to have made a bottom in Q3 2018, bucking the negative trend in DMs and global manufacturing. Perhaps this serves to underscore a bigger point: with the world economy no longer hauled by three locomotives (US, China, euro area), as it was in 2017, a powerful recovery in exports that lifts all boats does not seem forthcoming – at least until there is a revival in investment spending, the main propellant of trade. In turn, this highlights the rising importance of domestic demand – increasingly supported by fiscal policy – as the driving force of growth in a world economy that is recoupling lower.

Global Leading Indicator (GLI)

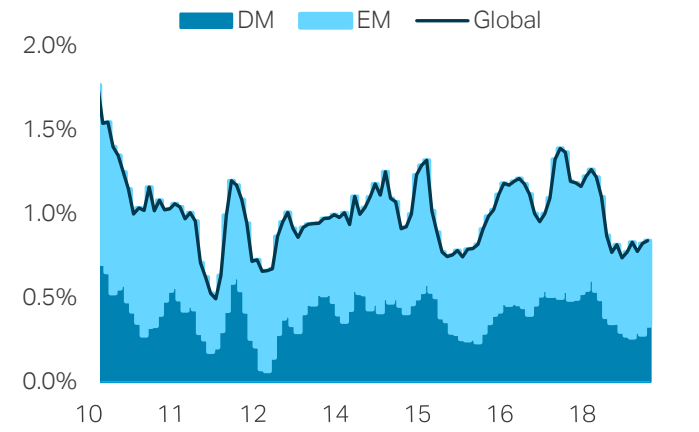
World GDP, QoQ



Source: Datastream, TS Lombard

Tentative signs of stabilisation

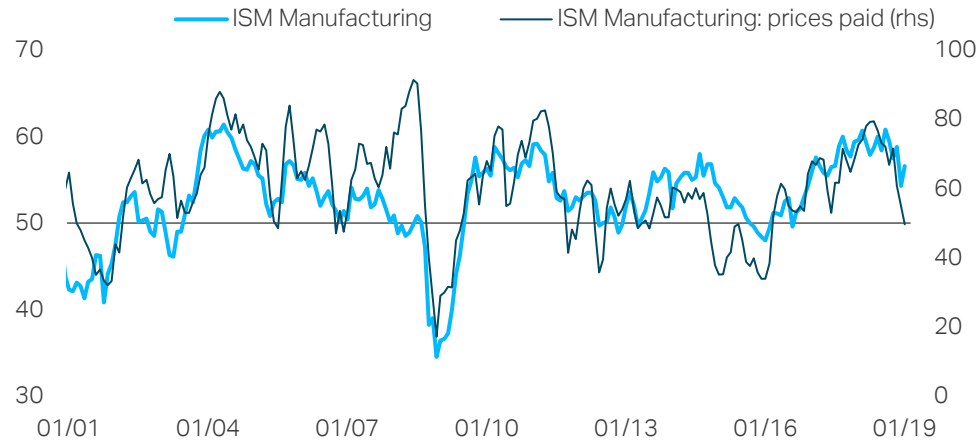
GLI and components



Source: Datastream, TS Lombard

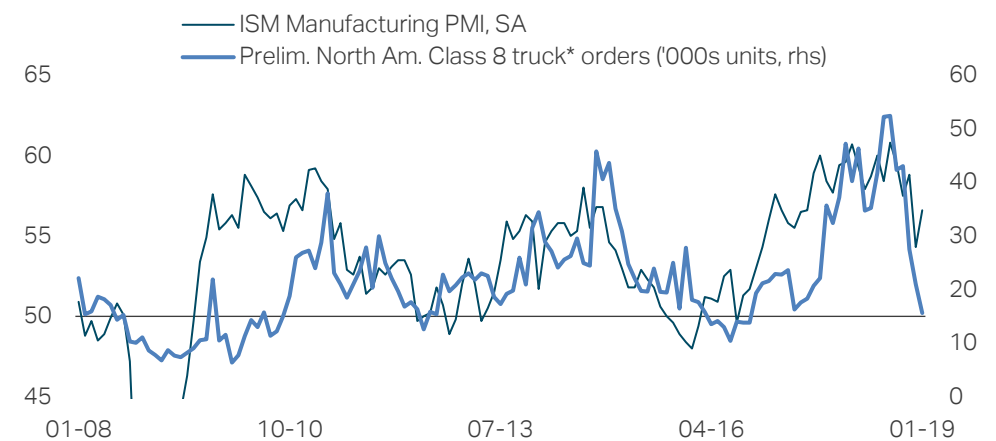
Warning signs

US manufacturing losing steam



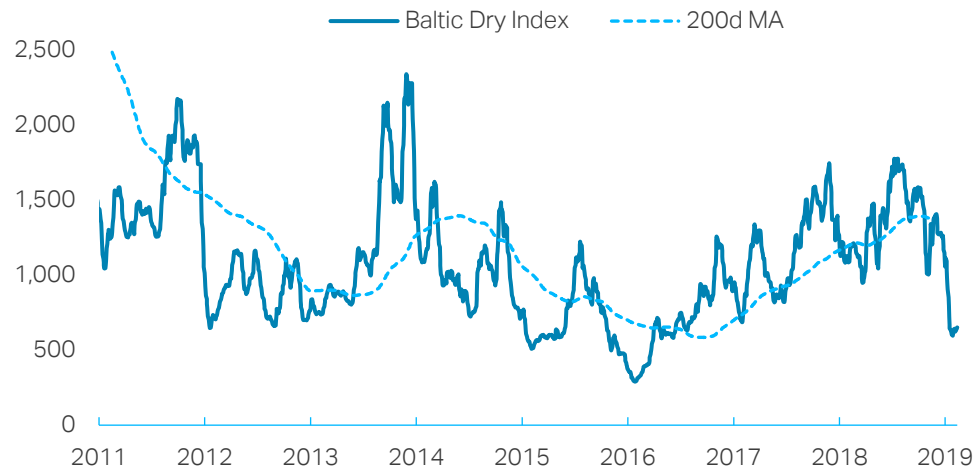
Source: Datastream, TS Lombard

Truck order collapse a bad omen



Source: Datastream, TS Lombard

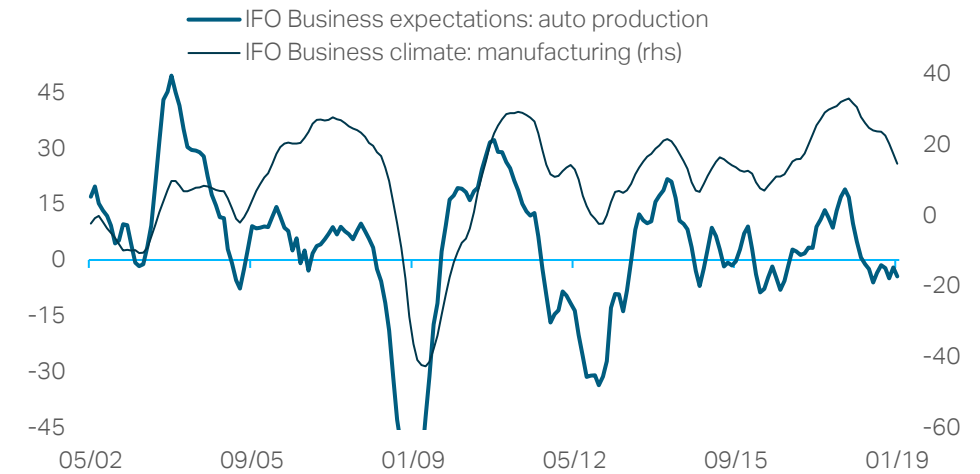
Shipping rates near the lows



Source: Datastream, TS Lombard

German automakers under pressure

3m MA



Source: Bloomberg, TS Lombard

Flashing orange

Tech cycle still pointing down

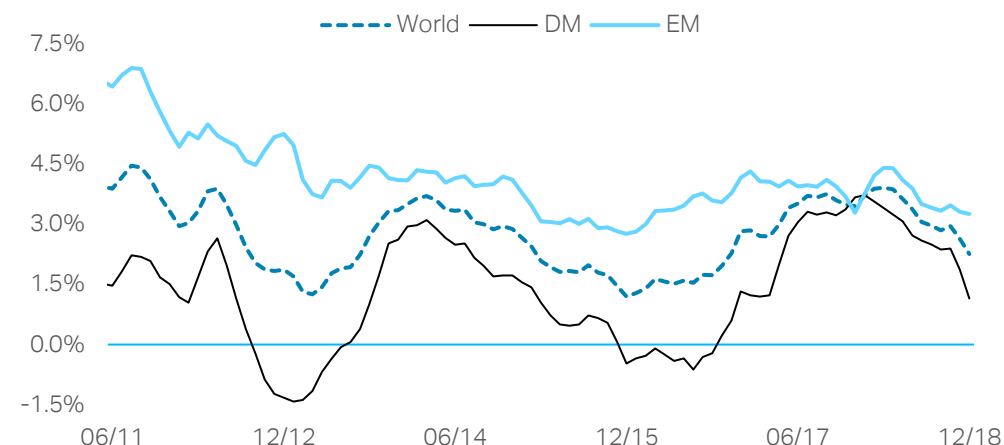
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Source: Markit, Datastream, TS Lombard

Synchronised dimming

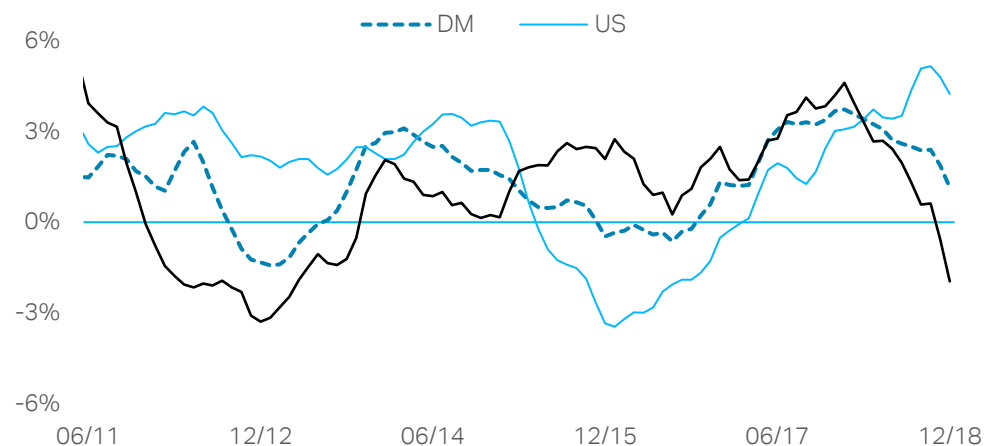
Industrial production, YoY (3m MA)



Source: CPB, Datastream, TS Lombard

Euro area a major drag on DMs

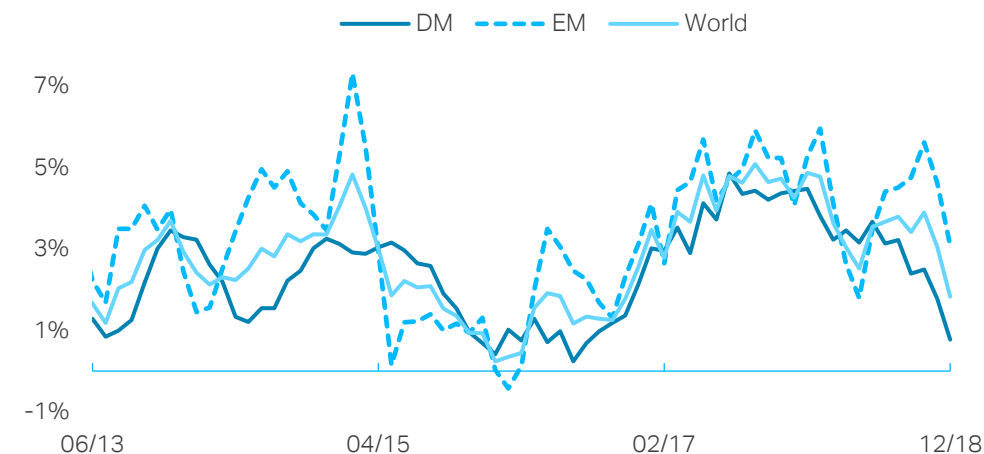
Industrial production, YoY (3m MA)



Source: CPB, Datastream, TS Lombard

World trade on the back foot

Export volumes, YoY (3m MA)



Source: CPB, Datastream, TS Lombard

The China factor

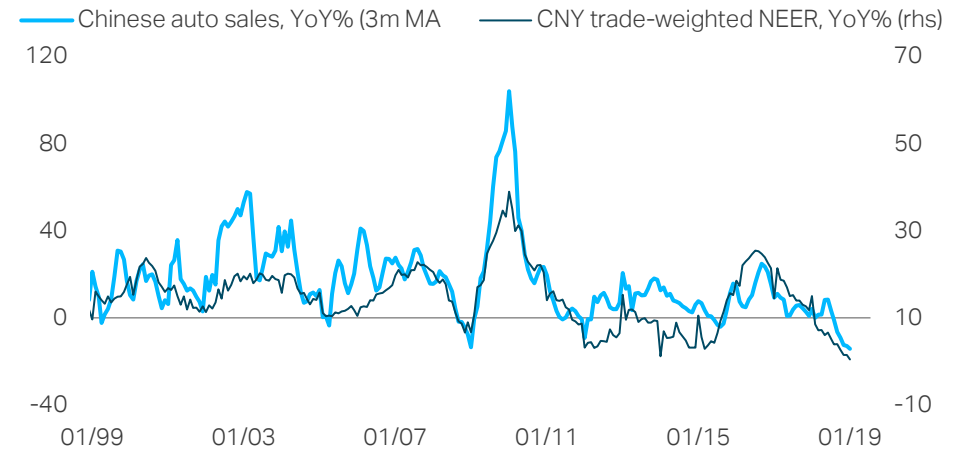
Slowing demand

3m MA



Source: Bloomberg, TS Lombard

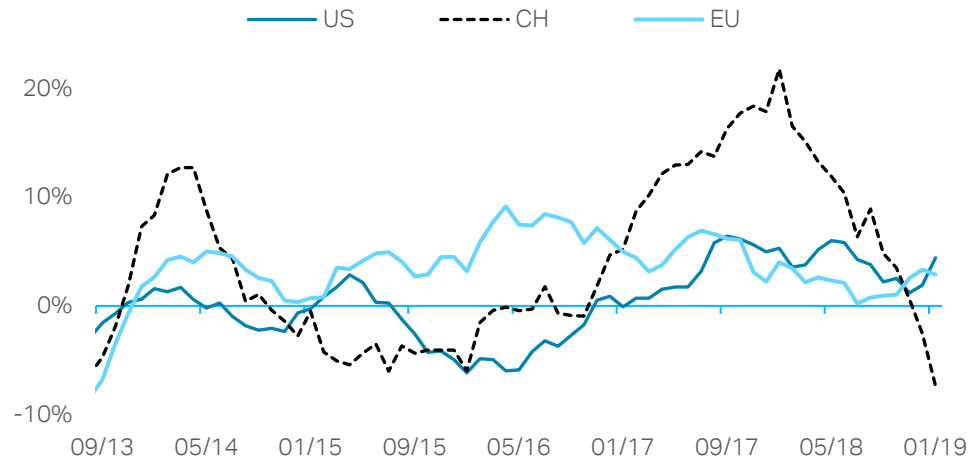
Speed bump



Source: Datastream, TS Lombard

Chinese flu

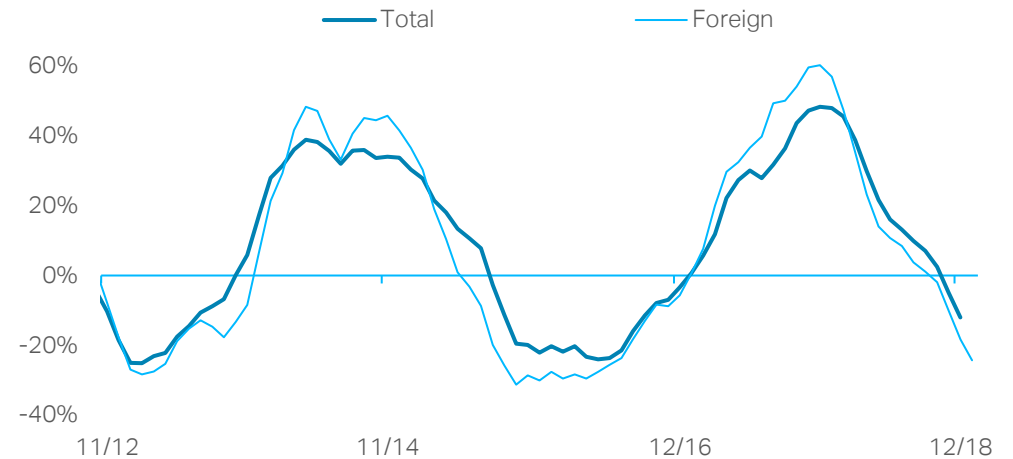
Japanese export volume by country, annual changes (6m MA)



Source: Datastream, TS Lombard

Japanese suppliers on the back foot

Japanese machine tool orders, YoY (3m MA)



Source: Datastream, TS Lombard

Global slowdown reaching US shores

Flagging momentum

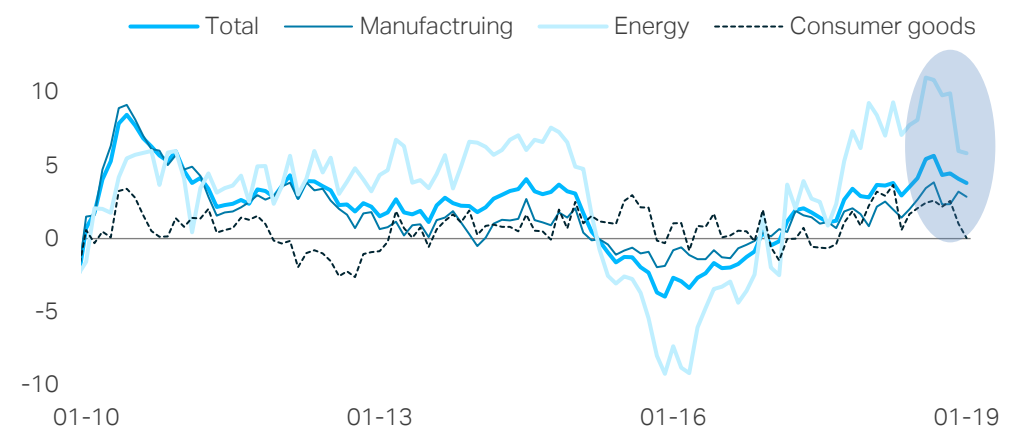
ISM Manufacturing survey, index



Source: Bloomberg, TS Lombard

Industrial activity shifting lower

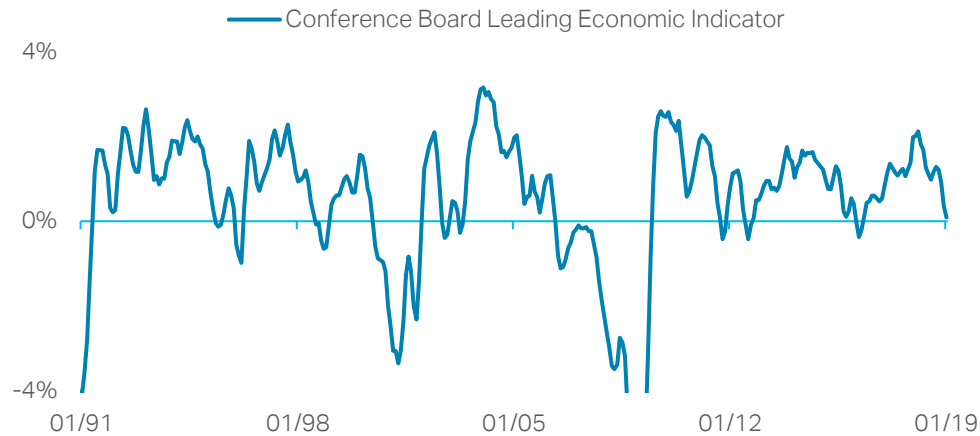
US industrial production, standardised



Source: Datastream, TS Lombard

Losing altitude

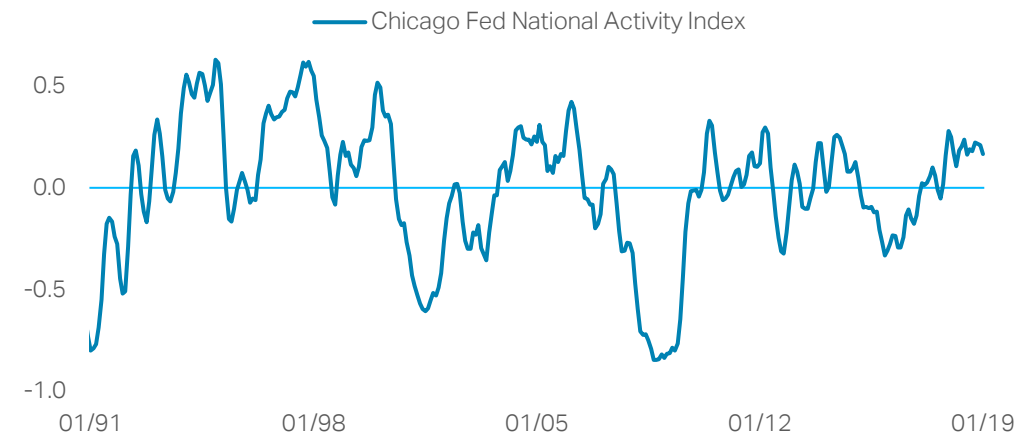
3m/3m changes



Source: Datastream, TS Lombard

Slim recession risk

3m MA

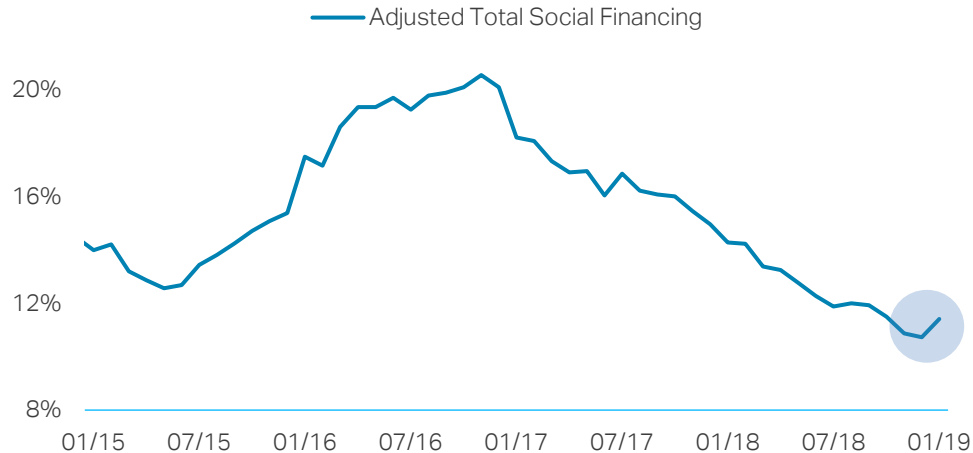


Source: Datastream, TS Lombard

China poised to turn the corner

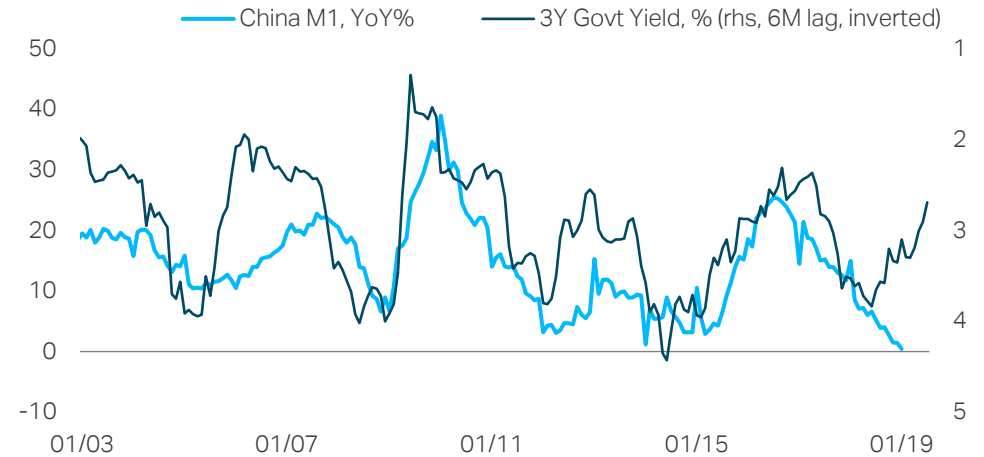
Credit easing on the way but still 'measured'

Annual change



Source: CEIC, TS Lombard

Money growth set to improve



Source: Datastream, TS Lombard

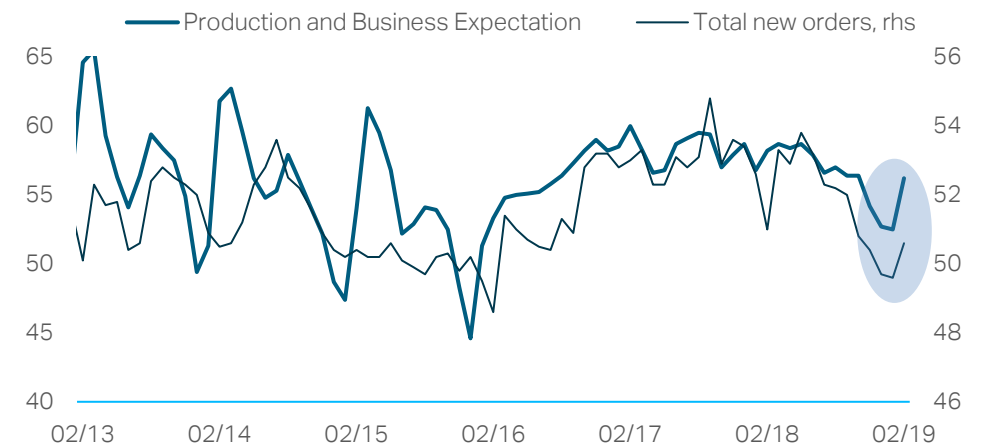
Beijing loosening the reins



Source: Bloomberg, TS Lombard

A turning point?

China Manufacturing PMI, index

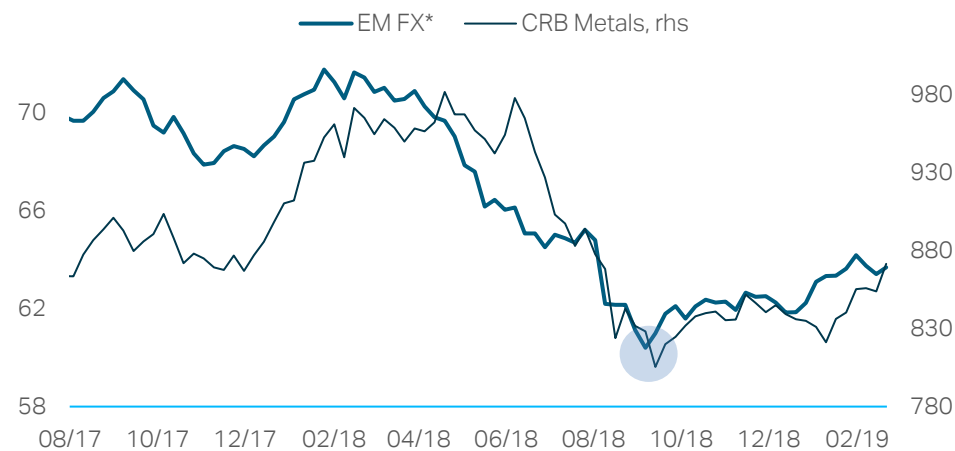


Source: CEIC, TS Lombard

Tentative signs of stabilisation

Bottoming out early

Index



Source: Bloomberg, TS Lombard

**JP Morgan EM Currency index*

Chinese stocks outperforming

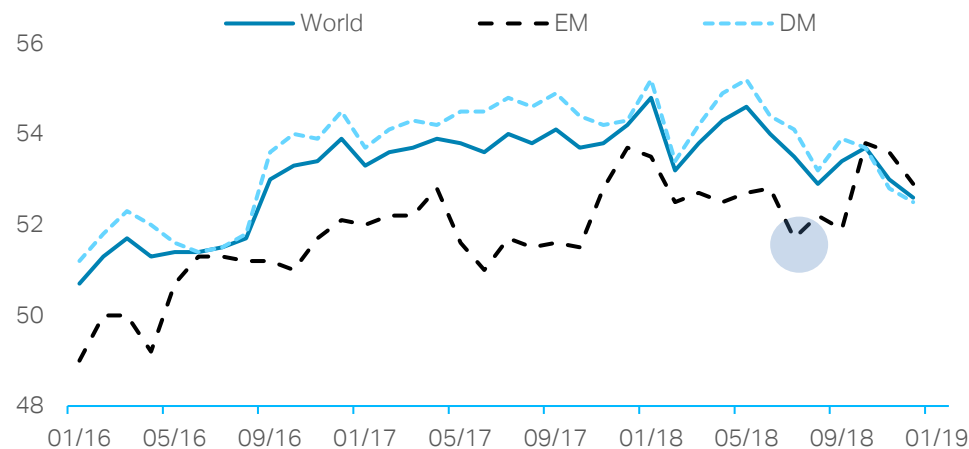
In US\$



Source: Bloomberg, TS Lombard

EM resilience

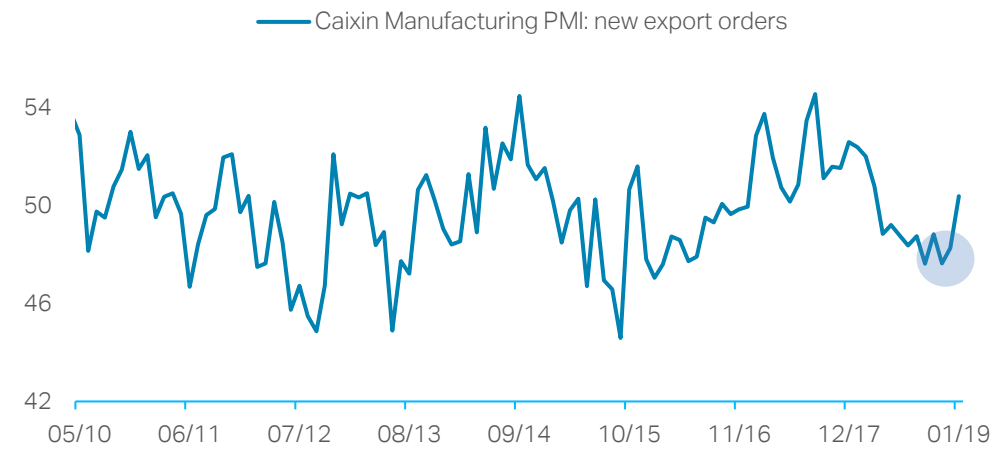
Services PMI



Source: Datastream, TS Lombard

Rays of hope

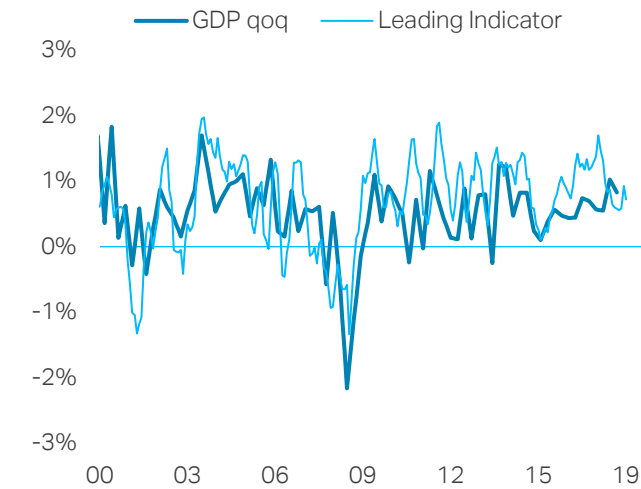
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Source: Datastream, TS Lombard

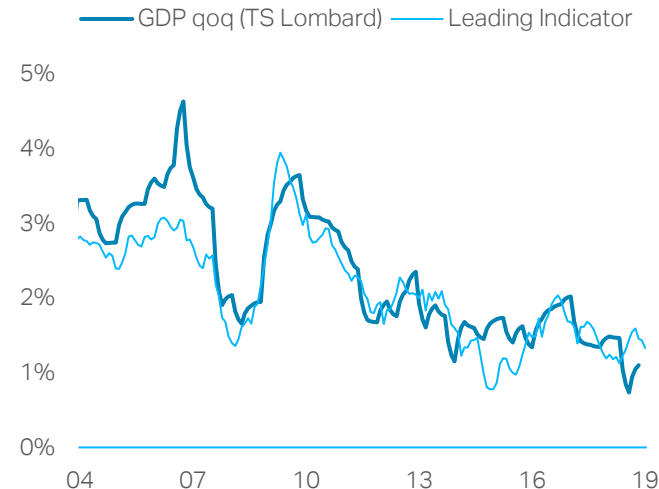
Appendix: TS Lombard Leading Indicators

United States



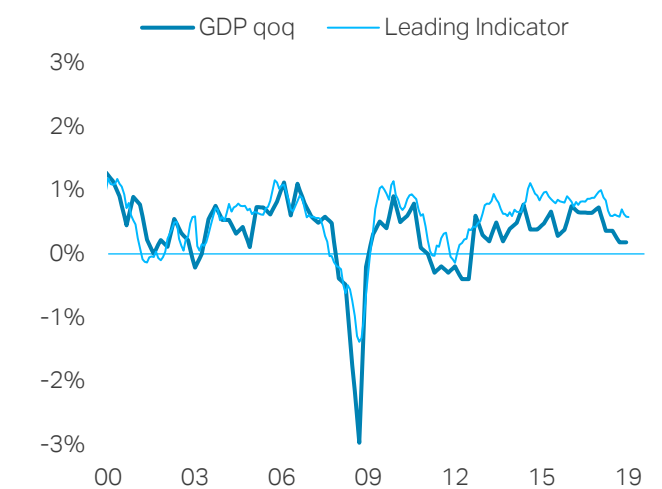
Source: TS Lombard

China



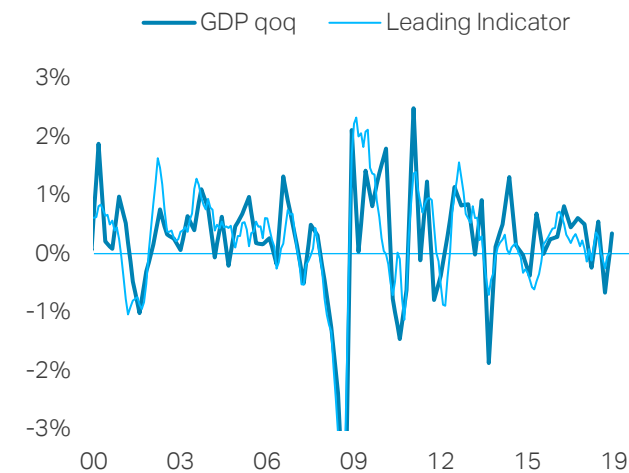
Source: TS Lombard

Euro area



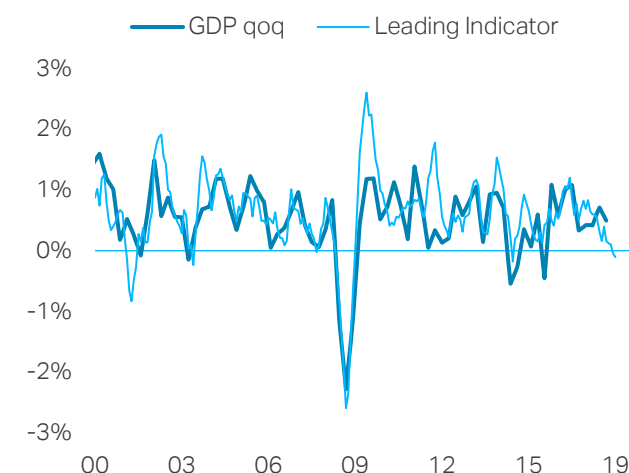
Source: TS Lombard

Japan



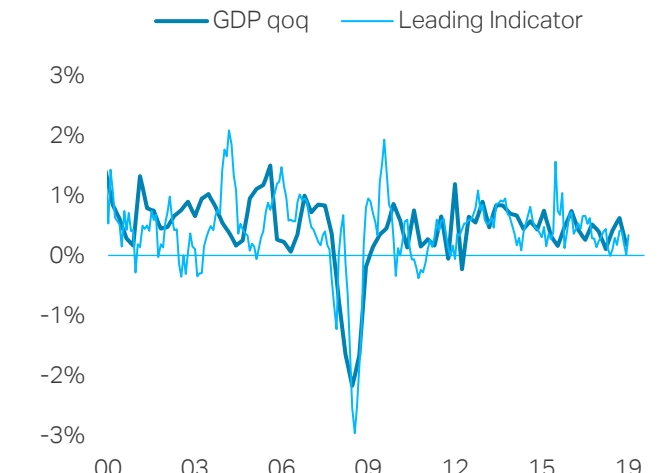
Source: TS Lombard

Canada



Source: TS Lombard

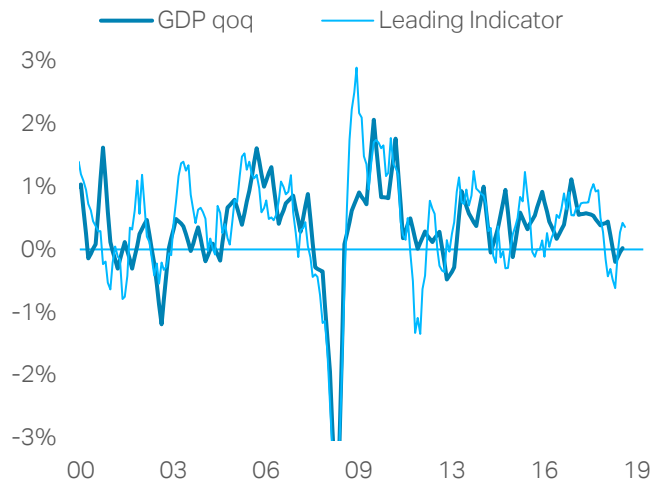
United Kingdom



Source: TS Lombard

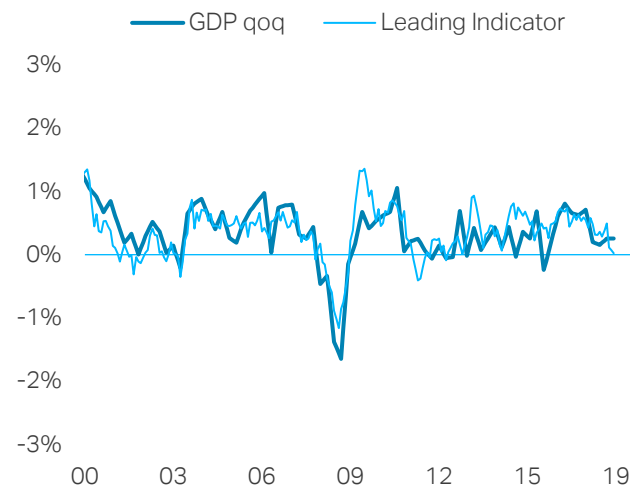
Appendix: TS Lombard Leading Indicators (cont.)

Germany



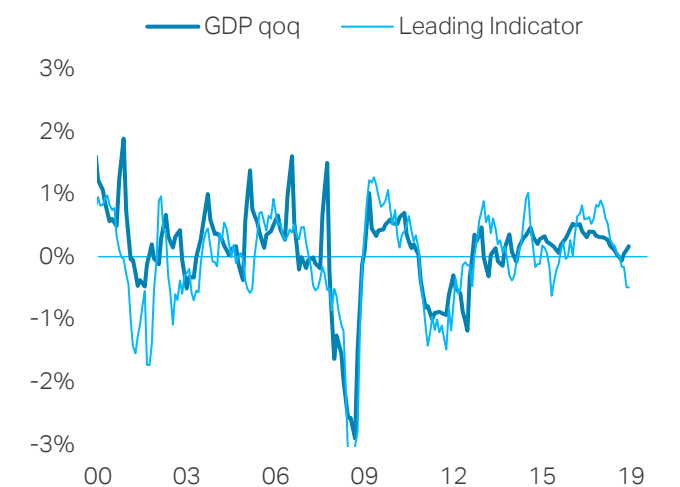
Source: TS Lombard

France



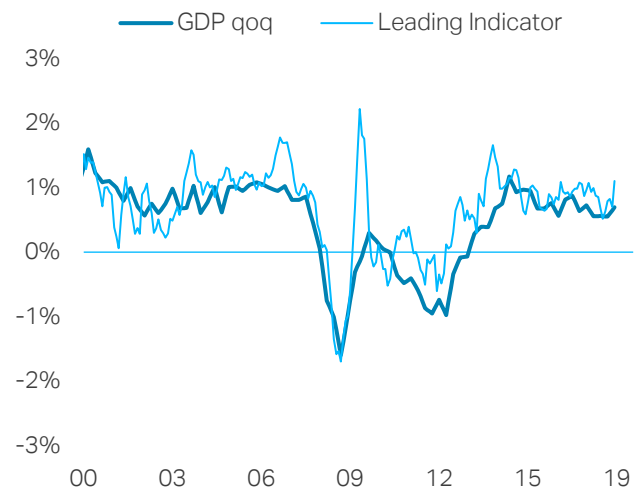
Source: TS Lombard

Italy



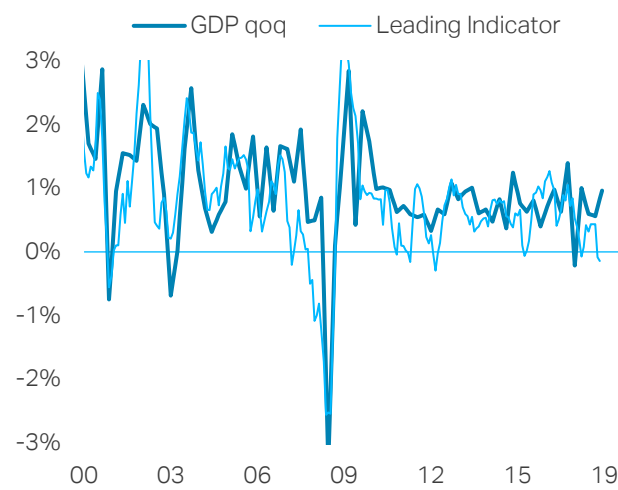
Source: TS Lombard

Spain



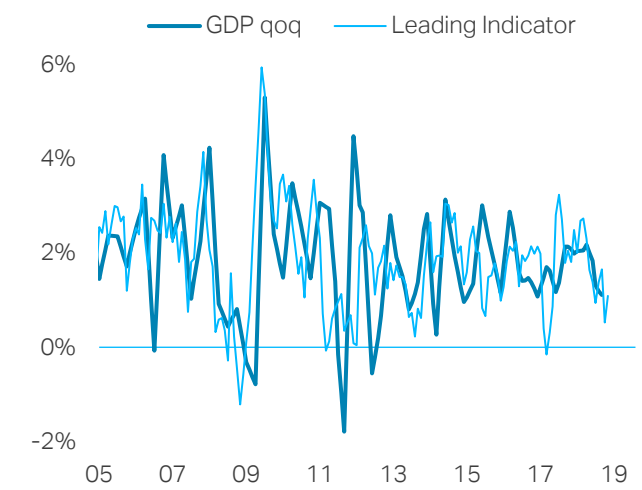
Source: TS Lombard

Korea



Source: TS Lombard

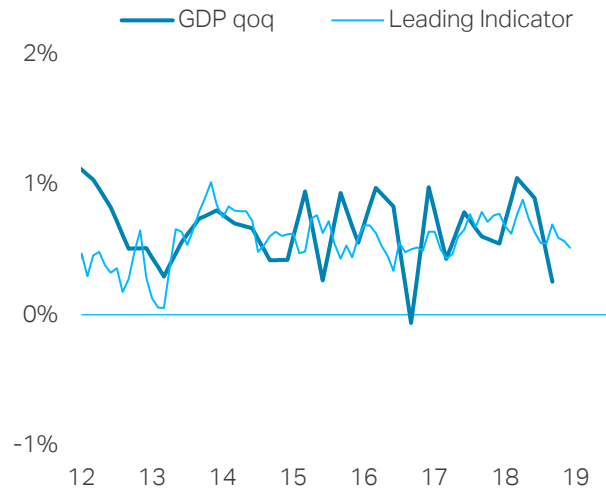
India



Source: TS Lombard

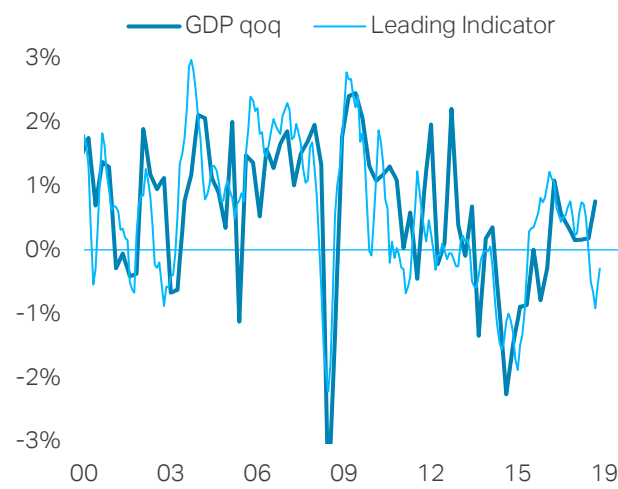
Appendix: TS Lombard Leading Indicators (cont.)

Australia



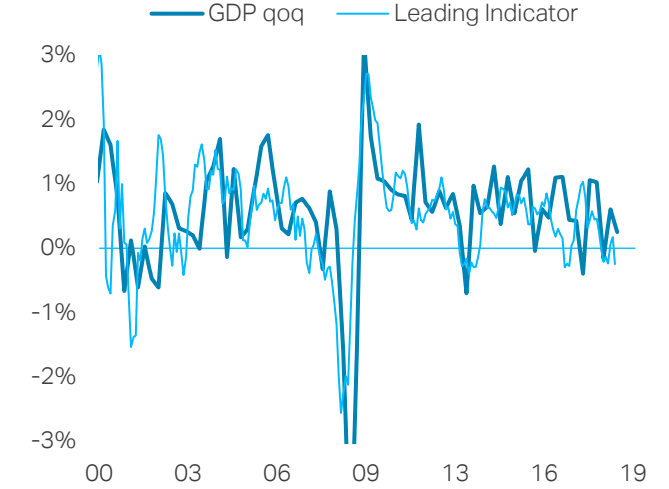
Source: TS Lombard

Brazil



Source: TS Lombard

Mexico



Source: TS Lombard

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