February 2019

MACRO BRIEF

In association with Cormorant Capital.

TOWN CLOSE
Financial Planning

LAST MONTH IN MACRO

OUTPUT AND EMPLOYMENT (EUROZONE)

A mixed bag

There was some good news and there was some bad news coming out of the eurozone last week.

Good news came in the form of a stabilised employment situation. This time last year the average rate of unemployment across the eurozone sat at 8.6 percent. The most recent figures, measured for the month of December, come in at 7.9 percent. And while 7.9 percent is the same rate as that recorded in the previous month, the actual number of those listed as unemployed fell by around 75,000.

The highest rate of joblessness is recorded in Greece (18.6 percent) and the lowest rate holds in the Czech Republic (2.1 percent). Unemployment stands at 9.1 percent in France (beaten by Wales over the weekend) 10.3 percent in Italy (beaten by Scotland) and 5.3 percent in Ireland(beaten, quite magnificently, by England).

Bad news for the eurozone (beyond the rugby) was dressed in the flash estimates for gross domestic product. If the preliminary figures are accurate, output growth increased at just 0.2 percent in the final quarter of last year. The equivalent year-on-year rate is thought to be 1.2 percent compared with 1.6 percent in Q3, 2.2percentin Q2 and 2.4 percent in Q1.

Those factors weighing on the eurozone average during the final quarter of last year include a (minor) recession in Italy, boarded-up and looted shops in France and low confidence among German export firms caught in the middle of a Sino-US trade war. Brexit too likely had an impact.

MANUFACTURING (CHINA)

Less bad

After four consecutive declines, the official China Purchasing Managers' Index for the manufacturing sector increased from 49.4 the month before to 49.5 during January. Still, a reading below the neutral 50.0 mark is hardly good news.

Meanwhile the unofficial PMI survey from Caixin/Markit suffered a sharp decline, falling from 49.7 in December to 48.3. The last time the Caixin measure was this low was in February 2016 when, just like today, Chinese stocks had shed close to 20.0 percent of their value.

EMPLOYMENT (USA)

100 not out

The non-farm payroll report counts 304,000 new jobs for January. That's considerably higher than consensus expectations for something like 165,000 new posts and represents the 100th consecutive month of employment gains. Wages are rising at a comparatively reasonable pace too; 3.2 percent comfortably outstrips year-on-year inflation running at close to 2.0 percent over the same period.

I'm not going to get too excited about this report, good as it is. For a start it came with a downgrade to prior estimates numbering 70,000 or so and January's mild start may have inflated the figures a little. On top of that the unemployment rate inched higher from 3.9 percent to 4.0 percent.

Data source: Eurostat, National Bureau of Statistics China, Caixin/Markit, Bureau of Labor Statistics.

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SERVICES PMI (UK)

Not with a bang

The British economy hasn't started 2019 particularly well. According to the IHS Markit/CIPS UK Services Purchasing Managers' Index press release…

'…January data indicated a renewed loss of momentum for the UK service sector, with a decline in incoming new work reported for the first time since July 2016. Subdued demand conditions meant that business activity was broadly flat at the start of 2019, while concerns about the economic outlook weighed more heavily on staff recruitment. Latest data pointed to an overall reduction in payroll numbers for the first time in just over six years.'

The index fell from 51.2 in December to 50.1 in January; a shade above the 50.0 neutral mark. Markit's Chief Economist, Chris Williamson, thinks that the latest survey results 'indicate that the UK economy is at risk of stalling or worse as escalating Brexit uncertainty coincides with a wider slower slowdown in the global economy.'

If you think that's downbeat, wait 'til you read what CIPS' Duncan Brock has to say…

'Optimism levels remained at some of the lowest levels since the last recession in 2009, the vice-like grip of Brexit is now taking hold of the sector, making it a very difficult start to the year and leaving little hope for improvement next month.'

Still, all this Brexit stuff will be over with in 47 days wont it.

MONETARY POLICY (UK)

Who knows

Last week, the Bank of England's Monetary Policy Committee opted to maintain Bank Rate at 0.75 percent and to maintain its stock of purchased assets at £435billion. Imagine that.

At the same time the Bank published its latest quarterly Inflation Report. Under normal circumstances the Inflation Report is, at least as far as I am concerned, a hugely important publication. But with Brexit still unclear, this one isn't going to be well-thumbed; I mean, everything is contingent on what happens on 29 March amid what the Bank refers to as a 'fog'.

For what it's worth, the Bank's current projections call for inflation in line with the 2.0 percent target, output growth a little over 1.0 percent and for unemployment to stay more or less where it is, close to 4.0 percent.

That all looks reasonable to me but you could change any one of those numbers quite a lot and it would still look quite reasonable to me. It's not difficult to argue a case for movements up or down dependent on where we find ourselves when the fog lifts.

For instance, the highest independent forecast for growth during this year comes from Bloomberg Economics - they've gone all sunny with a projection as high as 2.0 percent. Meanwhile, Economic Perspectives are forecasting grey skies with an increase as low as 0.8 percent.

Still, few serious firms are forecasting anything particularly unpleasant in the year ahead.

Data source: Markit/CIPS, Bank of England, HM Treasury.

LAST MONTH IN MACRO

GROSS DOMESTIC PRODUCT (UK)

Bad, very bad

According to the preliminary estimate from the Office for National Statistics (ONS), the total value of UK-wide economic activity amounted to £511,175 million during the fourth quarter of 2018. That's around 0.2 percent higher than it was at the end of the third quarter and around 1.3 percent higher than it was a year earlier. That's not too bad, I suppose. I mean, it's an increase isn't it.

The same cannot be said of growth for the month-on-month reading. December was witness to a 0.4 percent decline in activity. Let's hope that isn't sustained.

INFLATION (UK)

Give or take a month

Early last year I spoke of my expectation that inflation would fall toward the target rate much sooner than was widely predicted. That's pretty much what has happened. Last week, the ONS revealed a year-on-year increase in the headline Consumer Price Index of 1.8 percent during January. That's 0.2 percent lower than the Bank of England's 2.0 percent target and 0.3 percent lower than it was in the year to December.

Meanwhile, 'core' inflation – the Consumer Price Index excluding energy, food and booze – held steady at 1.9 percent. That tells you all you need to know; that falls in energy costs were the key contributor to a slower increase in aggregate prices..

GROSS DOMESTIC PRODUCT (JAPAN)

Boing

The world's third largest economy shrank at an annualised rate of 2.6 percent during the third quarter of last year. That was, at least in part, because of a major typhoon and, separately, a magnitude 6.6 earthquake that left a million homes without power for the better part of two days.

It seems though, that consumers and businesses bounced a bit of the way back during the fourth quarter. Japanese bean-counters at the Cabinet Office estimate that output increased at an annualised pace approaching 1.4 percent in the final three months of 2018.

INDUSTRIAL PRODUCTION (EUROZONE)

The luck of the Irish

Industrial production across the eurozone as a whole has fallen again; following a decline of 1.7 percent during November, December saw a fall of 0.9 percent.

As usual, the average hides a great deal of variability in the country-by-country data. Industrial production in Germany, for instance, increased at 0.2 percent and output in France increased by a comparatively speedy0.8 percent.

Meanwhile, the Irish – sandwiched between a slowing global economy on the one hand and heightened Brexit uncertainty on the other – saw industrial output fall by a whopping 13.4 percent.

Data source: Office for National Statistics, Cabinet Office (Japan) and Eurostat.

LAST MONTH IN MACRO

EMPLOYMENT SITUATION (UK)

Steady

The Office for National Statistics counts the unemployed proportion of the ‘economically active’ population at 4.0 percent in the most recent data (covering the three months to December2018).That’s in line with the prior count.

An estimated 32.6 million people are in work in the UK; 444,000 more than there was a year earlier. Of those, around 844,000 were employed on zero-hours contracts which, as it happens, is 57,000 fewer than at the same time last year. Meanwhile, 1.36 million citizens are ‘not in work but [are] seeking and available to work’ with a further 8.63 million said to be ‘economically inactive’.

MONETARY POLICY MEETING NOTES (USA)

A more balanced outlook

I’m still clinging to my early call for two rate rises from the Federal Open Market Committee (FOMC) in the year ahead that I have to admit I think I might be wrong.

The minutes from the most recent meeting of the FOMC reveal a dovish tone that jars with prior meetings. My reading suggests that the Fed is ready to pause in running down it’s balance sheet (by slowing or ceasing the reversal of earlier quantitative easing). That, if it isn’t dovish enough, opens to door to at least the possibility of a rate cut. I’m a long way from calling a rate cut but, today, my call for two rate rises looks brave.

INFLATION (EUROZONE)

Nothing alarming

On the face of it, Eurozone inflation is headed in the wrong direction. The year-on-year increase in the headline Consumer Price Index was 1.4 percent in January, down from 1.5 percent a month earlier. Meanwhile core inflation – which excludes volatile price changes in the energy and food sectors – increased from 1.1 percent to 1.2 percent. I’m inclined to focus on the core rate more than the headline rate and so I see little reason for alarm.

As is usual, the aggregated, eurozone-wide average hides a great deal of variability at the individual state level. Inflation ranges from a low of 0.5 percent in Greece to a high of 3.2 percentin Romania.

LEADING INDICATORS (USA)

Essentially flat

The Conference Board Leading Economic Index (LEI) represents an ‘analytic system designed to signal peaks and troughs’ in the US business cycle. I’m not altogether convinced that the think-tank boffins over at the Conference Board are always successful in their goal, but I am nonetheless happy to hear what they have to say. Last week, they published the results of their latest computations, summarising the outlook thus…

‘The US LEI has now been flat essentially since October 2018. The Conference Board forecasts that US GDP growth will likely decelerate to about 2 percent by the end of 2019.’ That sounds about right to me.

Data source: Office for National Statistics, Federal Reserve, Eurostat, Conference Board.

LAST MONTH IN WORDS

"On the whole, countercyclical economic policy hasn't had a significant effect. While domestic manufacturing demand shrank, external demand turned positive and became a bright spot amid positive progress in Sino-U.S. trade talks. As companies were more willing to reduce their inventories, their output declined, indicating notable downward pressure on China's economy. China is likely to launch more fiscal and monetary measures and speed up their implementation. Yet the stance of stabilizing leverage and strict regulation hasn't changed, which means the weakening trend of China's economy will continue."

Source: Dr Zhengsheng Zhong, Director of Macroeconomic Analysis at Caixin, 01/02/2019.

LAST MONTH IN WORDS

"Given the wide range of potential scenarios and the various paths to them, it would be remarkable if the current levels of sterling and other UK financial asset prices were consistent [with] the outcome that finally emerges."

Source: Mark Carney, Governor of the Bank of England,07/02/2019.

LAST MONTH IN WORDS

‘The use of vehicle bombs in the Kashmir insurgency may signify a shift in tactics. Militants on the receiving end of an increasingly robust counterinsurgency campaign are seeking new ways to strike Indian security forces beyond coordinated assaults against army installations. The attack also comes as Modi is preparing for a tough re-election campaign in parliamentary elections, which are due by May. Modi's Bharatiya Janata Party has long advocated for a muscular foreign policy against Pakistan, which it accuses of stoking the insurgency in Kashmir.’

Source: Stratfor, 14/02/19.

LAST MONTH IN WORDS

‘Cyclical stocks typically tied to the health of the U.S. economy have propelled the Dow Jones Industrial Average near a new alltime high, illustrating renewed investor confidence in the nearly 10-year expansion… [The] rally is largely tied to signals from the Federal Reserve that it has paused in its bid to raise interest rates, along with data pointing to strength in the labor market. Some investors are now wagering the slow but sturdy economic expansion will also continue into the second half of this year and exceed the record from the 1990s.’

Source:Wall St Journal,24/02/2019.

NOTES

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(1) MSCI United Kingdom Value, Bats 100, Bats 250, Bats UK Small Companies, S&P 500, Euro Stoxx 50, Nikkei 225, MSCI Brazil, MSCI Russia, MSCI India, MSCI China, Financial Analytics (2) MSCI United Kingdom, MSCI World ex Value, MSCI Emerging Markets, MSCI United Kingdom Value, Bats 100, Bats 250, Bats UK Small Companies, Barclays Gilt 1 – 5 Years, Barclays Sterling Gilts, Barclays Sterling Gilts 15+, Barclays UK Government Inflation Linked Bond, Financial Analytics (3) MSCI World, Barclays Global Convertibles, Barclays Global Treasury, MSCI World ex UK Large Cap, MSCI World ex UK Small Cap, MSCI World ex UK Value, MSCI World ex UK Growth, MSCI World, MSCI World Equal Weighted, MSCI World High Dividend, MSCI World Minimum Volatility, MSCI World Momentum, Financial Analytics (4) MSCI World Consumer Discretionary, MSCI World Consumer Staples, MSCI World Financials, MSCI World Health Care, MSCI Industrials, MSCI World Materials, MSCI World REITs, MSCI World Technology Hardware & Equipment, MSCI Telecommunications Services, MSCI World Utilities, Financial Analytics (5) SPDR FTSE UK All Share ETF, SPDR S&P 500 ETF, SPDR MSCI EMU ETF, SPDR MSCI Japan ETF, SPDR MSCI Emerging Markets ETF, SPDR Barclays Gilt, iShares Index-Linked Gilts, iShares Global Corporate Bond ETF, iShares Global High Yield Corporate Bond ETF, Mixed Assets assume separate equal weighted parcels of equity and bond exposure (6) Financial Analytics, overseas exposure assumes equal weight in US, Europe, Japan and Asia (7) Reference National Life Tables, Office for National Statistics, sustainable income assumes life expectancy, a gross 5 percent growth rate, annual income paid out at the start of the period.

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