

Monthly Cyclical Update - Mature Economies

MacroFinance Research – October 2018

United States

2018Q3 GDP growth at +3.5% q/q saar confirms the positive effect from fiscal stimulus on domestic demand, supporting US activity. We believe the current turmoil in financial markets will be temporary and thus with limited impact on confidence levels. The Fed will pursue its expected adjustment (+25bp in the 19th Dec. meeting) with the majority of the FOMC members in favor of gradual tightening of monetary policy.

- US GDP growth in 2018Q3 was +3.5% q/q saar (after 4.2% in 2018Q2), driven by personal consumption (2.7 pp) and government spending (0.6pp), both reflecting the impact of fiscal stimulus. However, the zero-contribution of fixed investment is disappointing and suggests that tax cuts have not yet translated into accelerating capex. Net exports subtracted -1.8pp from GDP but offset by strong inventory accumulation (2.1pp).
- GDP growth and the latest cyclical data remain consistent with our scenario of robust growth for end-2018. Importantly, the current financial market volatility and political uncertainties (tariffs and mid-terms elections) have so far had a limited impact on the latest confidence surveys. Both the Michigan Consumer Survey (98.6 in Oct., -2.1 pts), and the Composite PMI Survey (54.8 in Oct., up by 0.9 pts) are still close to historical peaks. This supports our view that the Oct. equity market sell-off is temporary and insufficient to have a significant impact on the US positive prospects which still prevail (at least until 2019H1), though financial volatility will be much higher than the past abnormally low 2017 levels.
- In this context, the Fed is likely to pursue its tightening of +25 bp per quarter (until 2019Q2). The September FOMC Minutes highlighting that most members are in favor with removing the accommodative bias of monetary policy. The complex “irregular upward translation” of the yield curve is set to continue.

Euro Zone

2018Q3 GDP growth first estimate at +0.6% q/q saar reinforces the view of a deceleration in economic activity, pulled down by weaker external demand and subdued confidence. It should remain positive and above 1.5%, i.e. still above potential. Despite higher risk factors (Italy, Brexit, Germany), the ECB is reluctant to adjust its forward guidance. We remain convinced that while QE extension is unlikely, the ECB will have to adjust its stance given the much higher difficulties for raising rates late in 2019.

- Aggregate Eurozone GDP growth at +0.6% q/q saar was slightly lower than expected. Monthly data confirm that our scenario of resilient domestic momentum, affected however by rising oil prices and combining with weaker external demand weighing on the expansion is still relevant, but downside risks become stronger. Protectionist threats induces higher uncertainties and weigh down on confidence. In October, the decline in Composite PMI (-1.4 pts to 52.7) is led by a drop in exports affecting the Manufacturing PMI (-1.9 pts to 52.1) but is also extending into Services sector (with drop in Services PMI by -1.4 pts to 53.3).
- In this context, specific subjects such as Italian risks (Budget, European Commission/ECB conflicts, spreads levels), the Brexit vote, Germany issues (coalition fragility, prospects for export-focused industries, auto sector) will continue to weigh on GDP growth, mainly through the high level of uncertainty. So far, those subjects are already incorporated in our scenario and are not likely to derail our forecasts without significant aggravation.
- On its October 25th meeting, the ECB remained on course for normalization acknowledging rising external risks but still confident on the ongoing economic expansion. Despite the current Italian context, the extension of the QE programme at the December meeting is unlikely. The ECB has other measures to implement including forward guidance, reinvestments and liquidity measures (LTRO) to limit sovereign risk.

United Kingdom

UK cyclical data confirm our positive outlook with GDP growth expected close to 1.5% in 2018H2 and 2019H1 despite uncertainties surrounding Brexit outcome that dampen confidence at the short-term.

- The economy grew by 0.7% in June-August 2018 compared to March-May, boosted in part by warm weather, suggesting a mild improvement in economic performances over 2018Q3, though accompanied by higher uncertainties and instability in confidence indexes.
- Cyclical data suggest an improvement in the manufacturing sector with industrial production expanding at 1.3% y/y in Aug. (1.0% in Jul.) and an expansion in output and new orders as indicated by the increase in the manufacturing PMI, at 53.8 in Sept. from 53 in Aug. The CBI industrial survey showed however that manufacturers have become less confident, and output growth was expected to stall in the three months to Jan.2019. GFK consumer confidence also dropped two points in Sep. to -9 and IHS Markit Household Finance Index (HFI), a measure of household's overall perception of financial wellbeing, declined to 45.1 in Oct. (from 45.7 in Sept.).
- The stabilization of unemployment rate at low level (4.0%) combined with a pick-up in average earnings (excl. bonus) growth at 3.1%, a highest since 2009, still make us confident about an improving consumer purchasing power supporting household spending. This is confirmed by retail sales expanding at a favorable 3.0% in Sept.
- Headline inflation moved along our scenario, slowing at 2.4% in in Sept., from 2.7% in Aug., as well as core inflation dropping from 2.1% to 1.9%. At this stage, we expect the Bank of England to maintain its "gradual and limited" approach while voting for a status quo on rates, and waiting for clarification on the Brexit process and potential implication. With the next EU Council meeting now scheduled for December 13-14, some politicians now refer to that meeting as when an agreement may be expected to come together.

Japan

Once again, highly volatile data make cyclical analysis complex but overall confirm our scenario of GDP oscillation around a slightly higher level, with potential for improvement in end-2019 if the government implements fiscal measures to limit the October 2019 VAT impact.

- 2018Q2 GDP growth was revised upward on 2nd estimate (from +1.9% to 3.0% q/q saar), mainly with strong increase in non-residential investment,

consistent with our GDP growth scenario driven by a robust capex cycle.

- The two drivers of Japan's economic expansion remain capex and exports. The latest data validate robust expansion in corporate investment with strong core machinery orders expansion (+11.0% m/m in Jul., +6.8% m/m in Aug.) and increase in the main business confidence surveys (Reuters Tankan, activity index, manufacturing PMI). The trade conflict between US and China does not seem to have any negative impact on Japan so far. The contraction in Sep. exports (-1.2% y/y after +6.6% y/y in Aug.) appears mainly linked to the impact of past natural disasters affecting distribution channels (and will probably affect the Q3 GDP growth). The export sales component in the Oct. PMI survey rose for the first time since May, suggesting short term increase.
- For the longer end of our scenario projections (2019H2), uncertainties are directly related to the implications and potential: mitigation of the planned hike in VAT rates. Indeed, discussions on, and plausible announcement of new measures to minimize the impact of fiscal contraction could lead to adjust upward our GDP growth projections.
- Although prices continue to be affected by the energy component, the effects are likely to fade into 2019, with core inflation below +1.0% y/y (at +1.0% in Sept.). In this context, our assessment of BoJ Monetary Policy remains unchanged: no significant monetary policy normalization process but larger fluctuation range on 10-year JGB yield.

Exchange rates and oil prices

- The EUR/USD reached 1.135 at end-October, pursuing the USD appreciation trend observed from end-September, in line with our scenario. The appreciation is expected to continue until early-2019 in the context of favorable long-term interest rate and GDP growth differentials between the US and the Eurozone. In addition, a potential rise in risk aversion would amplify this movement due to higher financial market volatility, geopolitical tensions and associated flight to safety.
- Oil prices have risen in October above 80\$/bl, consistent with our scenario of robust demand but supply constraints at the short-term. Prices would remain in the range 75-80\$/bl until the end of this year. Notwithstanding higher uncertainties regarding Saudi Arabia's political path and potential rise in geopolitical tensions in the Middle East, our scenario remains unchanged, with fading global demand expected in 2019 combining with easing supply-side constraints leading to prices below 65\$/bl after June 2019.

Economic Indicators Dashboard

Short term data for the United States, Euro Zone, United Kingdom and Japan

United States

Monthly economic data

	2018 M01	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
Industrial Production (y/y, %)	2.8	3.7	3.6	3.8	3.0	3.6	4.1	4.9	5.1
Consumer prices (y/y, %)	2.1	2.2	2.4	2.5	2.8	2.9	2.9	2.7	2.3
Producer Prices* (y/y, %)	2.6	2.8	2.9	2.7	3.1	3.4	3.3	2.8	2.6
Interest Rate - ST (Fed Funds, %)	1.4	1.4	1.5	1.7	1.7	1.8	1.9	1.9	2.0
Interest Rate - LT (10 years, %)	2.6	2.9	2.8	2.9	3.0	2.9	2.9	2.9	3.0
M2 (y/y, %)	4.3	4.1	4.0	3.8	3.8	4.2	3.9	4.0	3.9

* PPI for finished goods

Sources: BLS, FRB

Survey data

	2018 M01	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
ISM - Manufacturing PMI	59.1	60.8	59.3	57.3	58.7	60.2	58.1	61.3	59.8
ISM - Employment (% positive)	54.2	59.7	57.3	54.2	56.3	56.0	56.5	58.5	58.8
ISM - Production (% positive)	64.5	62.0	61.0	57.2	61.5	62.3	58.5	63.3	63.9
ISM - Prices (% positive)	72.7	74.2	78.1	79.3	79.5	76.8	73.2	72.1	66.9
ISM - New Orders (% positive)	65.4	64.2	61.9	61.2	63.7	63.5	60.2	65.1	61.8

Source: ISM (Institute for Supply Management)

Euro Zone

Monthly economic data

	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
Industrial Production (y/y, %)	2.5	3.5	2.2	2.4	2.5	1.0	0.5	--
Industrial Production excl. construction (y/y, %)	2.6	3.1	1.9	2.6	2.4	0.5	0.8	--
Consumer Prices (y/y, %)	1.1	1.3	1.3	1.9	2.0	2.1	2.0	2.1
Producer prices* (y/y, %)	1.4	1.7	1.8	2.9	3.4	3.4	3.2	--
Interest Rate - ST (EURIBOR 3 months, %)	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Interest Rate - LT (Euroland aggr. 10 years, %)	1.3	1.2	1.1	1.2	1.3	1.2	1.4	1.3
Interest Rate - LT (Germany Gvt Bond 10 year, %)	0.7	0.6	0.5	0.5	0.4	0.3	0.3	0.4
M2 (y/y, %)	4.9	4.4	4.2	4.6	4.8	4.4	3.9	4.2

* PPI for manufactured goods

Sources: ECB

Survey data

	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09	2018 M10
ECS – Consumer Confidence	0.1	0.1	0.3	0.2	-0.6	-0.5	-1.9	-2.9	-2.7
ECS – Industrial Confidence	8.8	7.0	7.3	6.9	6.9	5.8	5.6	4.7	--
ECS - Employment	10.3	9.7	9.4	8.2	9.3	7.7	7.0	7.3	--
ECS - Production	16.5	14.4	16.1	13.9	15.6	14.5	15.6	13.0	--
ECS - Prices	12.6	11.9	9.9	9.3	10.1	9.6	10.5	11.6	--
ECS – New Orders	10.1	8.3	7.4	9.1	7.6	6.1	5.0	5.4	--

Source: European Commission (ECS: European Commission Survey)

United Kingdom

Monthly economic data

	2018 M01	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
Industrial Production (y/y, %)	1.2	2.2	2.5	1.4	0.2	0.7	1.0	1.4	--
Consumer Prices (y/y, %)	3.0	2.7	2.5	2.4	2.4	2.4	2.5	2.7	2.4
Producer Prices* (y/y, %)	2.8	2.6	2.5	2.5	3.0	3.3	3.1	2.9	3.1
Interest Rate - ST (3 months, %)	0.3	0.3	0.3	0.4	0.6	0.6	0.6	0.6	0.6
Interest Rate - LT (10 years, %)	1.4	1.6	1.5	1.5	1.5	1.4	1.4	1.4	1.5
M4 (y/y, %)	5.4	5.1	3.0	2.1	2.8	2.6	3.0	2.0	--

* PPI for manufactured goods

Sources: Bank of England, UK Office for National Statistics

Survey data

	2018 M01	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
ECS – Consumer Confidence	-4.8	-4.1	-3.4	-5.9	-3.0	-7.0	-2.9	-3.6	-5.8
ECS – Industrial Confidence	13.0	6.4	0.1	5.1	3.6	5.9	7.0	7.6	5.4
ECS - Employment	7.1	13.9	15.1	10.2	4.0	9.9	9.0	4.7	4.1
ECS - Production	24.6	14.2	8.6	20.8	22.6	15.7	15.1	18.8	16.8
ECS - Prices	35.1	20.3	16.5	16.6	19.0	16.4	17.9	18.0	17.5
ECS – New Orders	15.5	10.2	5.7	7.3	0.5	10.2	11.2	4.8	1.5

Source: European Commission (ECS: European Commission Survey)

Japan

Monthly economic data

	2018 M01	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09
Industrial Production (y/y, %)	1.2	2.2	4.1	1.7	3.7	0.6	0.7	-0.4	--
Consumer Prices (y/y, %)	1.3	1.5	1.1	0.6	0.6	0.7	0.9	1.3	1.2
Producer Prices* (y/y, %)	2.7	2.5	2.0	2.0	2.6	2.8	3.0	3.0	3.0
Interest Rate - ST (3 months, %)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Interest Rate - LT (10 years, %)	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1
M2 (y/y, %)	3.4	3.2	3.1	3.2	3.2	3.1	2.9	2.9	2.8

* PPI for manufactured goods

Sources: Bank of Japan, Statistics Bureau

Survey data

	2018 M02	2018 M03	2018 M04	2018 M05	2018 M06	2018 M07	2018 M08	2018 M09	2018 M10
Consumer Confidence	44.3	44.3	43.6	43.8	43.7	43.5	43.3	43.4	--
Industrial Confidence (Nikkei PMI)	54.1	53.1	53.8	52.8	53.0	52.3	52.5	52.5	53.1
Industrial Conf. (Reuters Tankan)	29.0	28.0	21.0	22.0	26.0	25.0	30.0	26.0	28.0

Source: Statistics Bureau

Completed on October 30, 2018

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