Morning Comment

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AFS Insights

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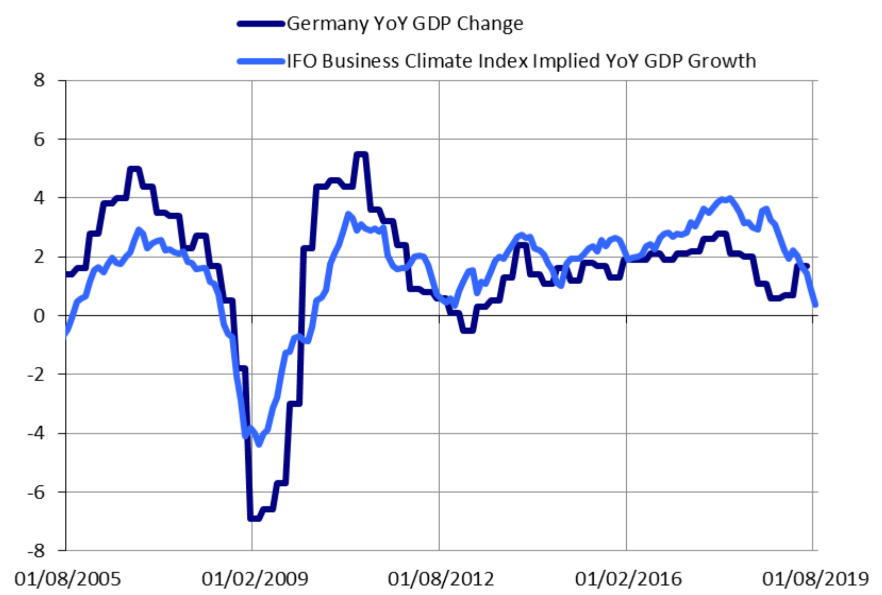
Headline Sweep

- Supreme Court to give historic Parliament suspension ruling
- Johnson Urges EU to Recognize He Has Compromised on Brexit
- China trade talks will happen in two weeks, Mnuchin says
- China Gives New Waivers for Tariff-Free U.S. Soybean Purchases
- PBOC's Yi Says China Is 'Not in a Rush' to Ease Policy Massively

Is the Eurozone headed for a recession?

- **Yesterday's Eurozone PMI data were simply awful.** The German manufacturing PMI in particular was a shocker, with the index falling to a 10-year low of 41.4**.** That doesn't bode well for this morning's German Ifo Survey, which is highly likely to print below consensus expectations of a marginal improvement.
- **In the second quarter German GDP contracted by 0.1%.** The current constellation of survey data point to a second straight quarter of negative quarterly GDP growth – a technical recession. But if recent Ifo data is any guide, German GDP will soon show year-on-year declines as well. Here are implied year-on-year GDP growth rates according to a regression of monthly Ifo data:



Source: Bloomberg; AFS

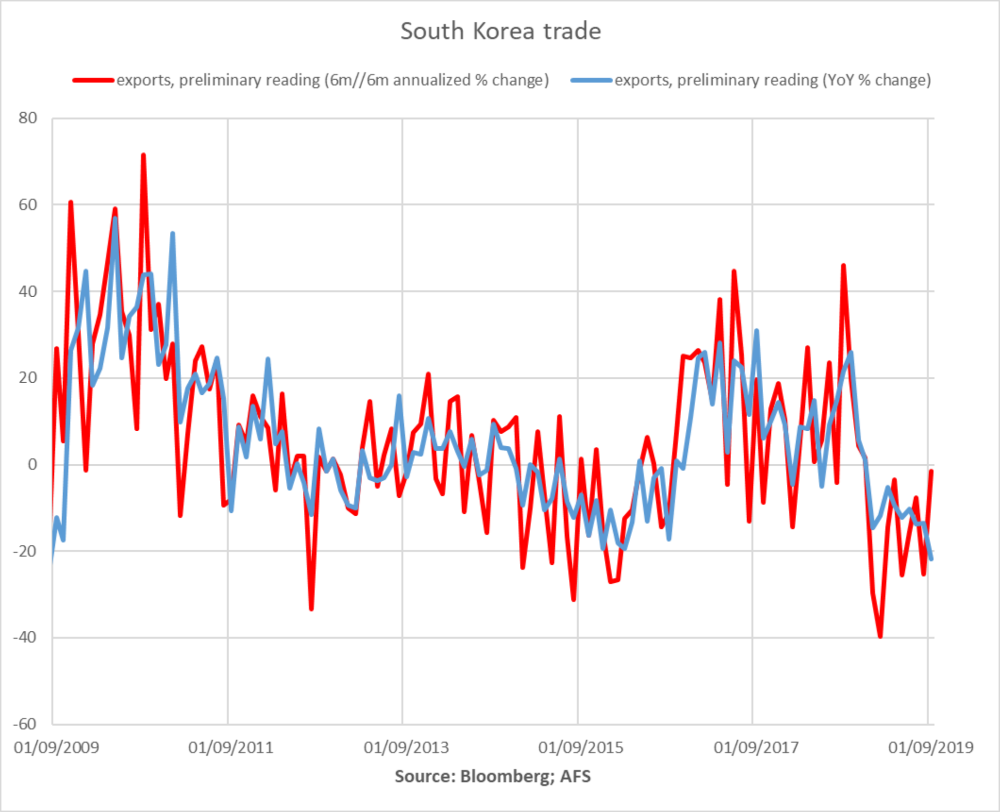
Note the strong deceleration in implied GDP growth rates.

- **Furthermore, if we make a regression with Markit's Eurozone PMI figures, we come up with quarterly GDP growth of 0.0% to 0.1%.** In other words: the economy of the Eurozone has stalled. Unfortunately, no improvement is in sight for the remainder of the year. Here's Markit official commentary to the PMI:

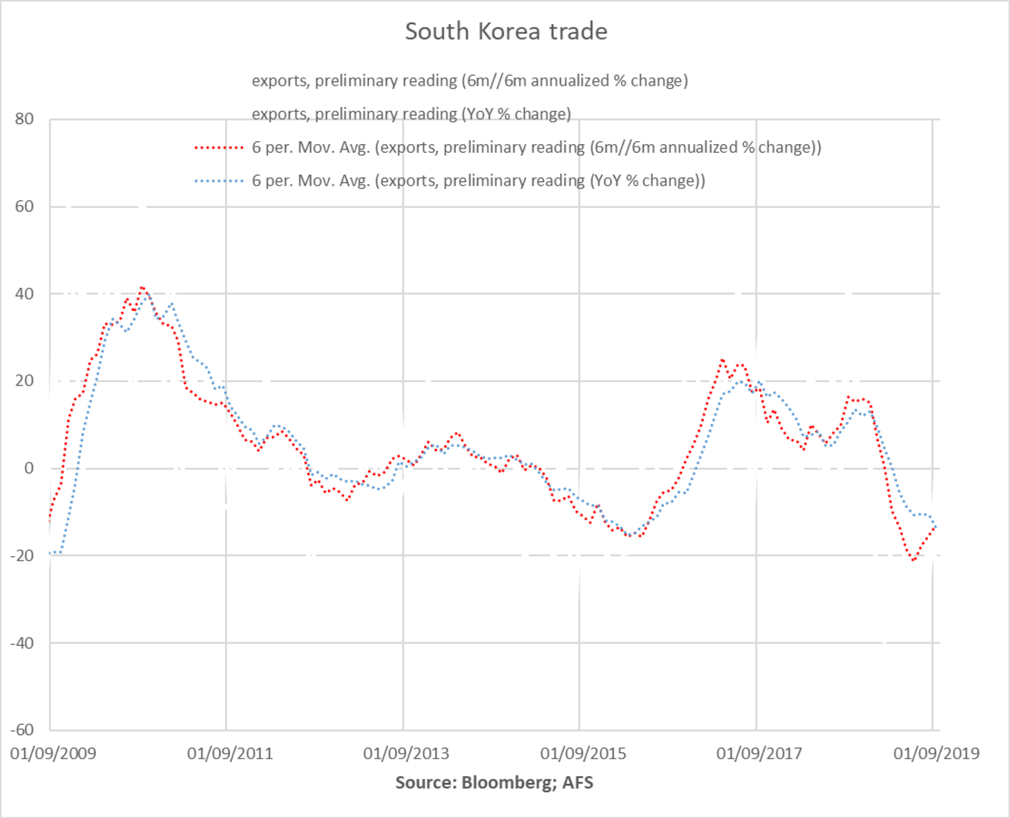
  "The goods-producing sector is going from bad to worse, suffering its steepest downturn since 2012, but a further worrying trend is the broadening-out of the malaise to the service sector, where the rate of growth has now slowed to one of the weakest since 2014. The details of the survey suggest the risks are tilted towards the economy contracting in coming months. Most vividly, new orders for goods and services are already falling at the fastest rate since mid-2013, suggesting firms will increasingly look to reduce output unless demand revives."

- **With the benefit of hindsight, Eurozone growth rates peaked by the end of 2017.** In the second half of last year the underlying growth rate fell below the potential rate of growth. And from then on things went from bad to worse. In fact, the Euro Area is on track for full year growth of just 0.8%, which compares with the ECB staff forecast of 1.1%. For the record: the annual rate of potential growth is about 1.5%.
- **By now it's clear that the ECB shouldn't have ended QE last December**.[1] That decision was only partially reversed this month. Partially because rebelling hawks won a few converts among the centrists on the Governing Council. Truth be told, with exports making up almost 50% of GDP the effectiveness of domestic demand policies is severely limited. At this stage our central bank overlords in Frankfurt are hoping and praying the global economy will soon bottom out. Fortunately, on that front, the data have been less bad then feared.
- **Yesterday the Korean government released its monthly preliminary trade data, showing a 21.8% year-on-year decline.** The plunge in exports was in large part a result of seasonality. To adjust for base-effects, we prefer the 6-month/6-month annualized percentage change, which also happens to lead the conventional year-on-year change by several months. Here's the chart:

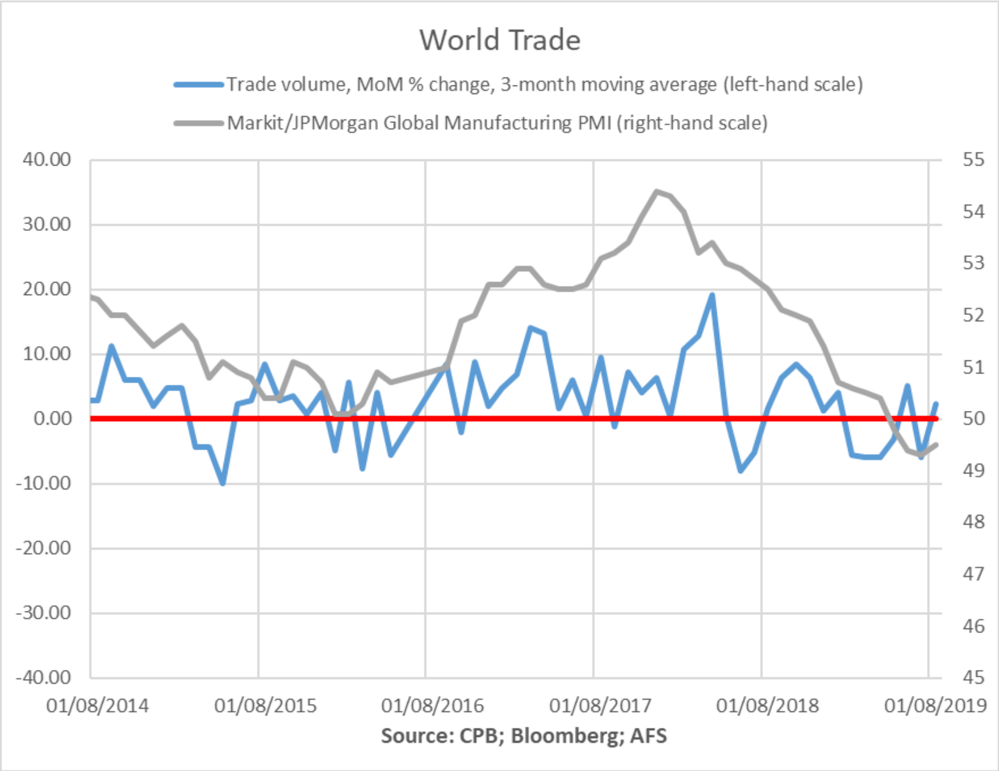
[1] Like every sane person we prefer easier fiscal policy and not a further easing of monetary policy. Alas, politically this has proven to be politically impossible. We do not expect the Eurozone fiscal stance, as measured by the cyclically adjusted primary budget balance, to become stimulative next year. Note that according to the IMF's latest Fiscal Monitor, the cyclically adjusted primary surplus should hoover around a half a percent of GDP this and the next several years.



And smoothed:



- **South Korean exports appear to be bottoming out, which would be a welcome positive sign for global growth**. Note that in August, the last month for which we have data, the Markit Global Manufacturing PMI showed the first improvement since 2018:

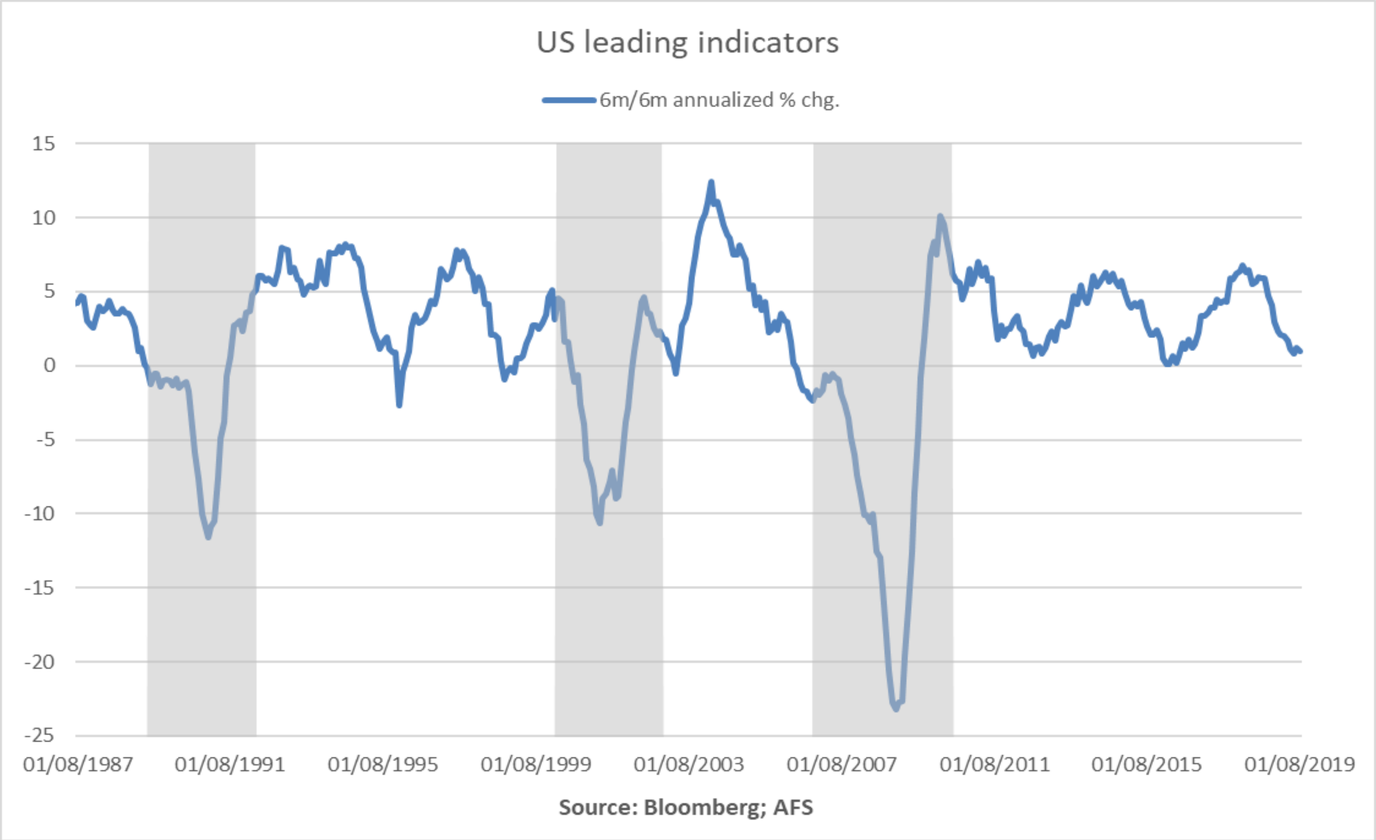


- **Bottom line: neither the Euro Area economy nor the global economy are out of the woods.** Euro Area growth continues to deteriorate, while it's too soon to conclude that global growth is bottoming out. Still, things aren't falling of a cliff. An in case of the Eurozone, we showed that our favorite forward-looking indicator – real M1 growth 12 months ahead – is not consistent with a recession. In fact, real M1 is consistent with growth picking up over the course of 2020. Be aware that real M1 growth has a perfect track record in signaling turning points in the Euro Area business cycle. Every upswing and downturn have been correctly 'predicted' by real money growth.
- **On a side note, Markit also released the US PMIs for September yesterday.** While the US survey wasn't as bad as its Euro Area counterpart, things are not looking up for the US economy. The headline output index was flattish at 51.0, which is consistent with slightly below potential growth. The details of the survey were pretty weak, unfortunately. New order growth softened in the services sector, which was offset by a slight improvement in new business in the manufacturing sector. But it was the employment component that really drew our attention:

  "Jobs are now also being cut across the surveyed companies for the first time since January 2010, as firms have become more risk averse and increasingly eager to cut costs. At current levels, the survey employment index is indicative of non-farm payroll growth falling below 100,000."

While the Fed may claim payrolls growth of around 100k is consistent with stable unemployment, we disagree. Payrolls has to be around 150k to keep the economy on an even keel.

- **Furthermore, our other favorite US business cycle indicator, the Conference Board's Leading Indicators (LEI), also shows the US economy is not out of the woods, and that the pressure on the Fed to ease in Q4 remains.** Below we've charted the 6-month/6-month annualized percentage change in the leading indicators. Note that negative readings are consistent with a recession.



- **The leading indicators tells that the US economy is flirting with a recession for a third time this cycle, and the danger hasn't gone away.** The elevated recession risk is reflected in the yield curve inversion. The 3-month/10-year Treasury yield spread has been inverted for 95 days. However, the 2y10y spread has only briefly and modestly inverted this cycle:

	3m10y inversion # of days inverted	First inversion date	Last inversion date	max inversion, in bps	average inversion, in bps
July 1990-March 1991 recession	101	27/03/1989	28/12/1989	-35	-12
March 2001-November 2001 recession	145	05/04/2000	09/02/2001	-82	-44
December 2007-June 2009 recession	230	22/02/2006	08/08/2007	-72	-29
March 2019 yield curve inversion	95	22/03/2019	---	-56	-19

	2y10y inversion # of days inverted	First inversion date	Last inversion date	max inversion, in bps	average inversion, in bps
July 1990-March 1991 recession	185	14/12/1988	29/03/1990	-44	-15
March 2001-November 2001 recession	233	03/02/2000	02/01/2001	-56	-26
December 2007-June 2009 recession	245	27/12/2005	05/06/2007	-20	-19
March 2019 yield curve inversion	8	14/08/2019	---	-5.3	-1.8

- **The partial inversion muddles the message of the yield curve.** We believe the lack of a sustained inversion in the 2y10y spread is the result of the Fed (partially) heeding the message from the 3m10y inversion – Chair Powell's "sustaining the expansion" and all that. Furthermore, the White House is into yield *curvology* these days, with President Trump hounding the Fed with calls for rate cuts and QE. However, if the Fed takes its eyes of the ball (the yield curve that is) and becomes more concerned about financial excesses and starts dragging its feet on rate hikes, the 2y10y spread will probably do go the way of the 3m10y inversion. Then again, such an inversion will very likely invoke a response from the White House, putting the Fed under relentless pressure to ease ASAP. Bottom line: Trump and the Fed want to kill your recession call, and they're more likely to succeed, and delay the inevitable recession until after the elections.

Calendar

TIME	REGION	EVENT	PERIOD	ACTUAL	CONSENSUS	REVISED	PRIOR
02:30	Japan	Jibun Bank PMI Manufacturing	Sep P	48.9	--		49.3
02:30	Japan	Jibun Bank PMI Services	Sep P	51.5	--		53.3

TIME	REGION	EVENT	PERIOD	CONSENSUS	PRIOR
08:45	France	Business Confidence	Sep	105	105
08:45	France	Manufacturing Confidence	Sep	101	102
09:00		ECB's Villeroy speaks in Paris			
09:30		Riksbank's Ingves and Jansson in Parliamentary Hearing			
10:00	Germany	IFO Business Climate	Sep	94.5	94.3
10:00	Germany	IFO Expectations	Sep	92	91.3
10:00	Germany	IFO Current Assessment	Sep	97.0	97.3
11:30		ECB Main Refinancing Operation Result			
11:30		UK Supreme Court Ruling on Prorogation (expected)			
11:30	Germany	Sells 5 Billion Euros of 0% 2021 Bonds			
11:55		RBA Governor Lowe Gives Speech in Armidale			
12:30		Bank of Spain Releases Economic Forecasts			
14:00		ECB's De Guindos Speaks at Money Market Meeting			
14:00		Hungary Central Bank Rate Decision	Sep-24	0.90%	0.90%
14:00		Hungary Overnight Deposit Rate	Sep-24	-0.05%	-0.05%
15:00	Belgium	Business Confidence	Sep	--	-5.8
15:00	US	S&P CoreLogic CS 20-City MoM SA	Jul	0.10%	0.04%
15:00	US	S&P CoreLogic CS 20-City YoY NSA	Jul	2.20%	2.13%
16:00	US	Richmond Fed Manufacturing Index	Sep	2	1
16:00	US	Conference Board Consumer Confidence	Sep	133	135.1
16:30		ECB's De Guindos Speaks in Frankfurt			
19:00	US	Sells USD40 Bln 2-Year Notes			
		United Nation General Debate			
		Trump Speaks at UN			

Consensus data: Bloomberg News; All Times Are in Central European Time