Has Spring Sprung?

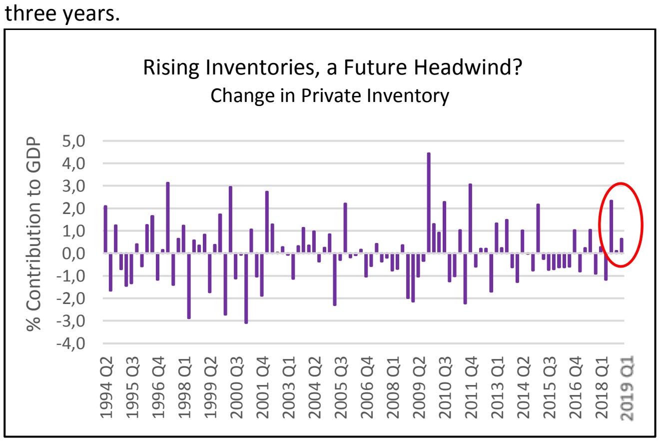
David F. Lafferty, CFA, SVP – Chief Market Strategist May 2019

Just Don't Say "Green Shoots"

The post-Christmas global rally in both equities and corporate credit has everyone wondering, "Is global growth stronger than we expected?" Obviously the Fed's downshift both on rates (now on hold) and its balance sheet (no longer on autopilot) was a huge boost for risk assets. However, we also can't help but feel that investors are seeing (or imagining) new spring growth after the fourth quarter's killing frost. In this month's note, we examine the most recent macro data to see if it supports a continued rally in stocks and credit.

US GDP Head Fake

In light of the first quarter's GDP reports, it makes sense to start in the US. On the surface, the quarterly real GDP print of +3.2% annualized was more than solid – better than consensus at 2.3% and much better than the 1.0%–1.5% expectation that prevailed from November through February. So much for all that recession talk investors were obsessing over. Yet unfortunately for the macro bulls, the underlying details of the report were relatively weak. Personal consumption fell by more than half from Q4 (1.2% vs. 2.5%) while business investment was lackluster, boosted solely by the less tangible "intellectual property" component. Moreover, growth was artificially juiced by an unlikely-to-be-repeated collapse in imports. In addition, business inventories, which will eventually have to be liquidated, jumped for the third quarter in a row. All this left "final domestic sales" at a much-less-impressive +1.3% for the quarter. Keep in mind, all this "real" data was further bostered by the weakest price adjustment in three years.



Source: Bloomberg, Natixis Investment Strategies Group, Q2:1994 – Q1:2019 (Quarterly)

Even so, all is not lost. While we consider 3.2% growth to be a head fake, we still see very little in the data that would imply that growth is stalling or that a recession is imminent. US manufacturing data has stabilized and the ISM Composite Index at 56.0 would still be associated with real GDP near 3%. In recent years, strength in the ISM data has overestimated GDP, so we doubt 3% is the true long run trajectory. However, even if this remains the case, this level of activity would still justify an economy growing at 1.5%–2.0%. Conveniently, that coincides with our unchanged view that the US economy is decelerating toward potential GDP near 2%, but not going into recession – at least not in the near term.

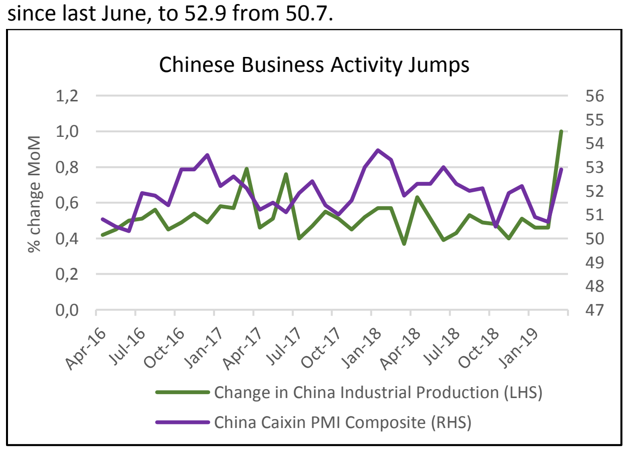
Europe: Subdued But Positive

In Europe, the growth outlook remains somewhere between dull and dreary, although not outright negative as many would have you believe. In spite of well-known political and structural headwinds, Europe is growing. It just isn't growing very fast. After bottoming in January, the Euro Area Composite PMI Index has stabilized in recent months while GDP is running at +1.2% YoY. First quarter GDP perked up +0.4% QoQ, the highest reading since Q2 last year. Across the largest economies, German business activity is improving after its automotive and manufacturing slowdown, France has regained modest momentum, and the UK remains in solid territory, if only due to the transitory effects of pre-Brexit inventory building.

All told, the European economy is growing in the 1.0%–1.5% range – unspectacular but consistent with its longer-term potential GDP rate. Growth is subdued, but moving in the right direction.

Is China Bouncing Back?

Similar to the US, more recent data coming from China looks significantly better than last year's second half slowdown. Weakness in Chinese exports appears to be fading while industrial production shot up 1.0% in March – the largest monthly jump in five years. With this improving data as a backdrop, there should be little surprise that the China Caixin PMI Composite Index rebounded in March to its highest level since last June, to 52.9 from 50.7.



Source: Bloomberg, Natixis Investment Strategies Group, May 2016 – March 2019 (Monthly)

However, like the US head fake, investors should be skeptical of the data coming from Beijing for several reasons. First is the usual caveat – we don't believe the data is falsified, but it is certainly massaged. Second, some of the statistical rebound could be transitory, emanating from timing differences around the Chinese New Year. And third, policymakers may be seeking to improve the appearance of macro conditions to strengthen their hand in trade negotiations with the US. We simply can't know. However, setting aside the overall accuracy of the data, there is a larger concern: Even if the Chinese economy were beginning a resurgence, we have to wonder how much of it is simply more debt-driven stimulus. Stimulus that is unlikely to be sustained in an environment where President Xi is actively trying to wean the economy off of excessive leverage and debt. We suspect the improvement in China's data is at least partially due to this fiscal accordion, where leverage is unleashed to combat slowing growth and subsequently reined in when growth accelerates.

Ironically, it is precisely this centrally-planned fiscal flexibility that, in the short run, allows policymakers to arrest a slowing economy (as they are doing now), or slow credit creation in a speeding economy. In the long run, however, given the policy mandate to rein in excessive credit growth, China is subject to the same supply-side arithmetic as the rest of the world. This math implies that China's longer run potential real GDP is somewhere in the 5.0%–6.0% range, just below the current reported GDP trend (low-to-mid 6% range) of the last 3+ years.

Dead Flowers

Based on the above data, we return to our original question: Should investors get excited that global growth is about to bloom? That's a bit too optimistic in our view. Yes, there are some positive signs, but we see the improvement, such as it is, to be both modest and a bit transitory. However, at the margin, the global economy certainly hasn't gone dormant and we think any oncoming recession may be pushed a bit further into the future.

While the data is somewhat better, we believe the underlying trajectory of the global economy has changed very little. Growth is at worst slowing toward its long run potential, and at best, not booming but merely showing signs of stabilizing. Absent an inflation surprise (in either direction), neither outlook is extreme enough to move the US Fed to tighten or loosen policy in the near term. With the Fed on hold for now, and consistent with our view for several quarters, slow but positive growth should be supportive of stocks and credit. Broad economic growth, however, is not strong enough to warrant more aggressive risk taking. With apologies to the Rolling Stones, we don't see "dead flowers every morning", but be careful not "to put roses on your grave."

David F. Lafferty, CFA®
Senior Vice President – Chief Market Strategist

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