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Global Macro Themes

Growth disappoints, Central banks don’t

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The global economy continues to slow down

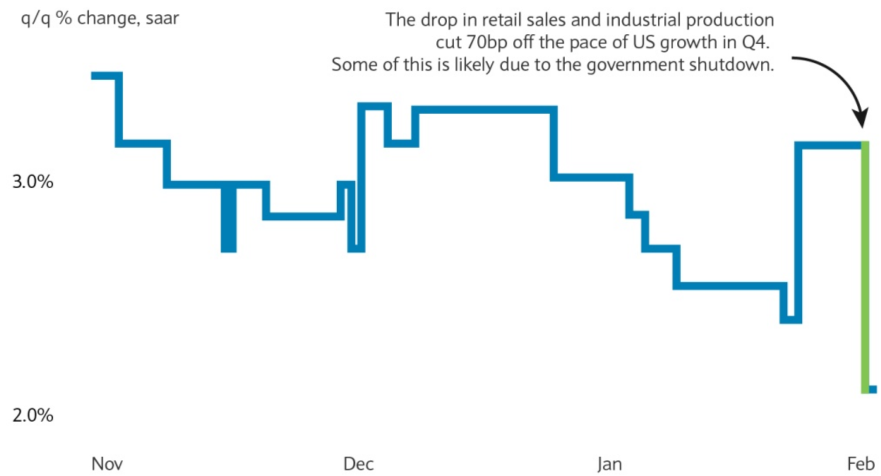
1 Since our last update one month ago, there have been twice as many disappointments as upside surprises.

Date	Region	Economic data	Direction	Latest	Prior	Comment
29-Jan	US	Consumer confidence	▼	120.2	128.1	Consumer confidence dips amid shutdown and market volatility
30-Jan	China	NBS manufacturing	△	49.5	49.4	Stabilization but likely to be short lived, we think
31-Jan	US	Chicago PMI index	▼	56.7	65.4	Eased amid fall in new order
31-Jan	China	Caixin manufacturing	▼	48.3	49.7	Confidence declined to lowest level in three years
1-Feb	US	Nonfarm payrolls	△	304	222	Exceeded expectations but prior revised down. Participation rose.
1-Feb	US	ISM manufacturing	△	56.6	54.1	Manufacturing sector activity rising at a good pace
6-Feb	Germany	Factory orders	▼	-1.6	-1.0	Contraction driven by slowdown in foreign demand
14-Feb	US	Retail sales ex autos	▼	-1.8	0.0	Steep decline amid concerns about partial government shutdown
14-Feb	China	Producer Price index	▼	0.1	0.9	PPI deflation in sight; especially worrying for nominal growth
15-Feb	China	M2 growth	△	8.4	8.1	Smaller than prior Jan expansion but should support Q2 growth
21-Feb	United States	Existing home sales	▼	4.94	4.99	Broad based decline in home sales across regions
21-Feb	Europe	Manufacturing PMI	▼	49.2	50.5	Manufacturing confidence dips into contraction
21-Feb	Europe	Services PMI	△	52.3	51.2	Services confidence exceeds expectations, offsets industry
22-Feb	Germany	IFO surve: business climate	▼	98.5	99.1	German business confidence continues to decline

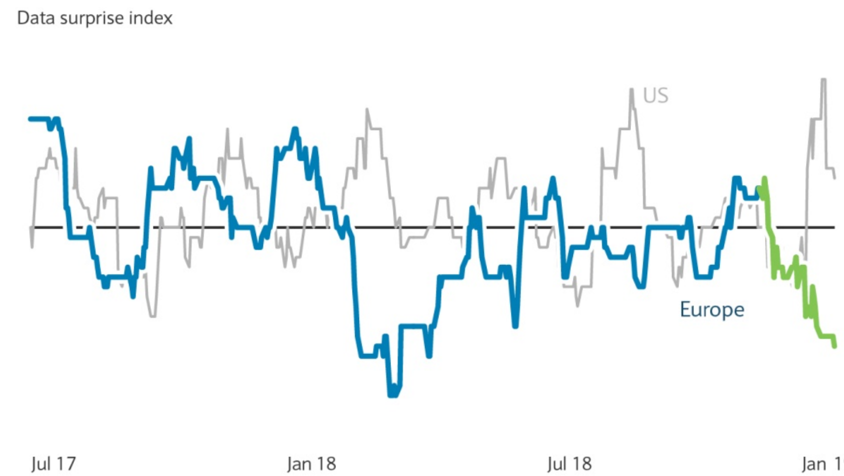
Source: Bloomberg, Barclays Research

Europe in particular disappointed, driven by Germany

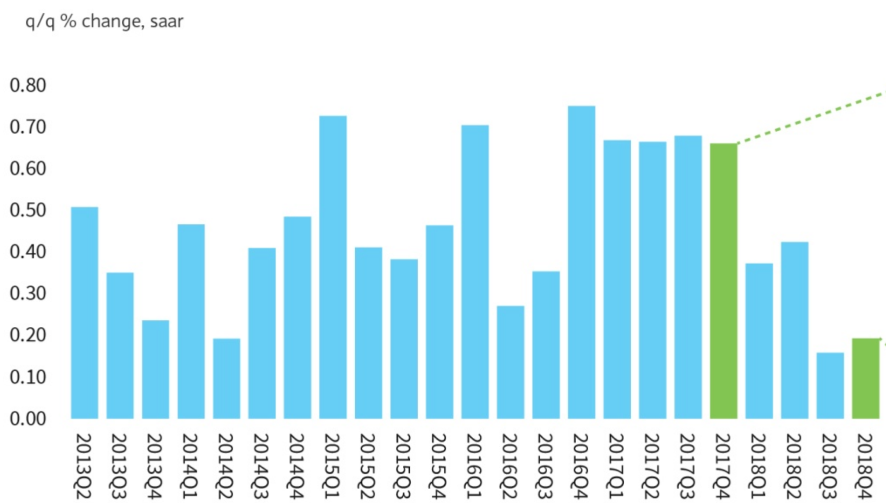
2 We are tracking Q4 US GDP lower...



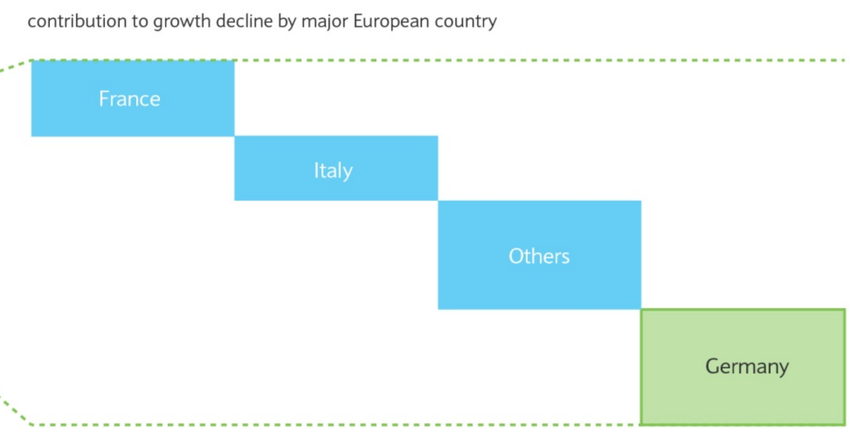
3 ...but the main source of disappointment has been Europe.



4 European growth has slowed since the end of 2017...



5 ...driven by Germany in particular

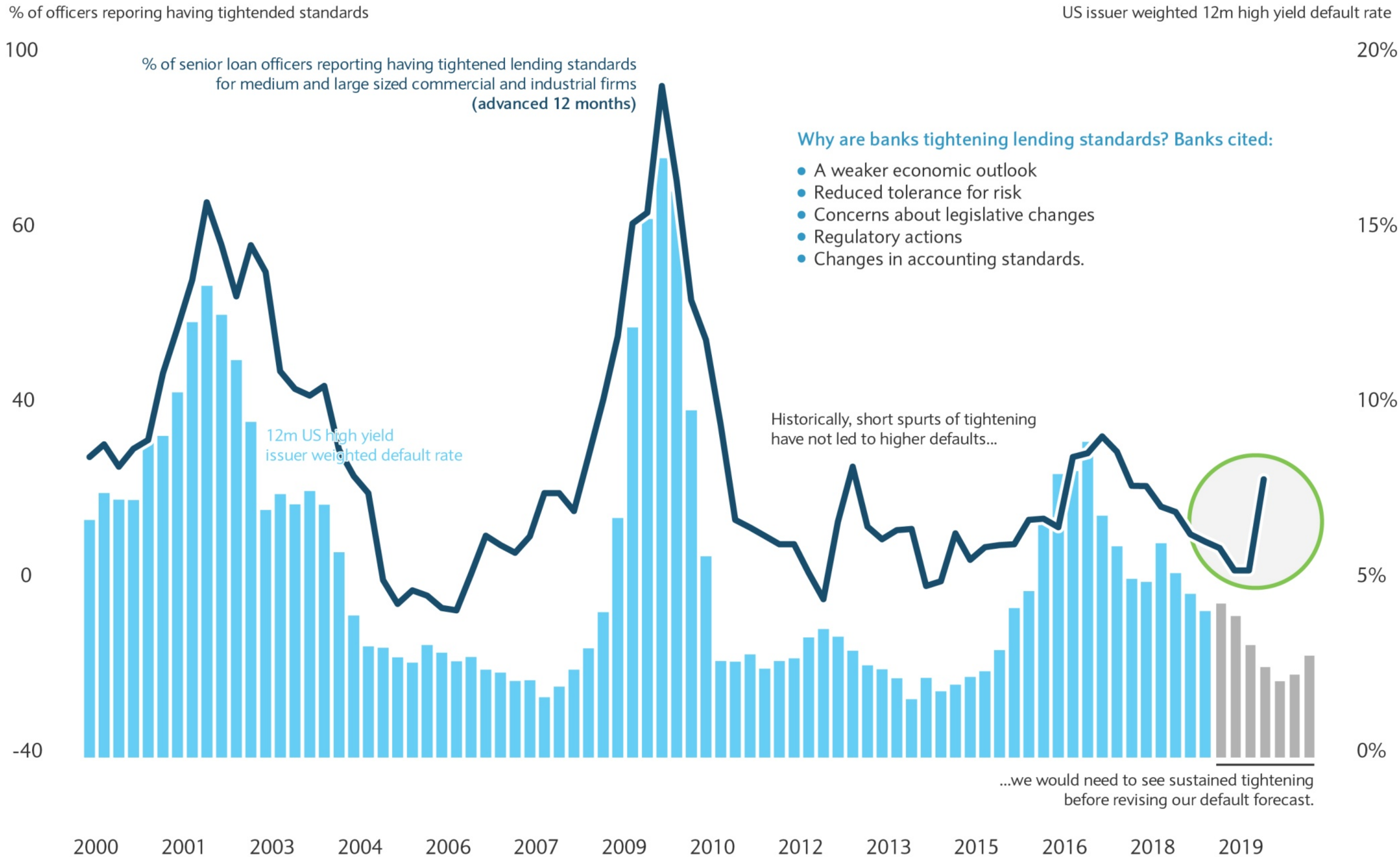


An open manufacturing-focused economy like Germany is affected more than others by weaker global trade, the slowdown in China, and Brexit. But domestic fundamentals are healthy. We forecast growth picking up this year.

Source: Bloomberg, Barclays Research

Bank lending standards are tightening in the US and Europe

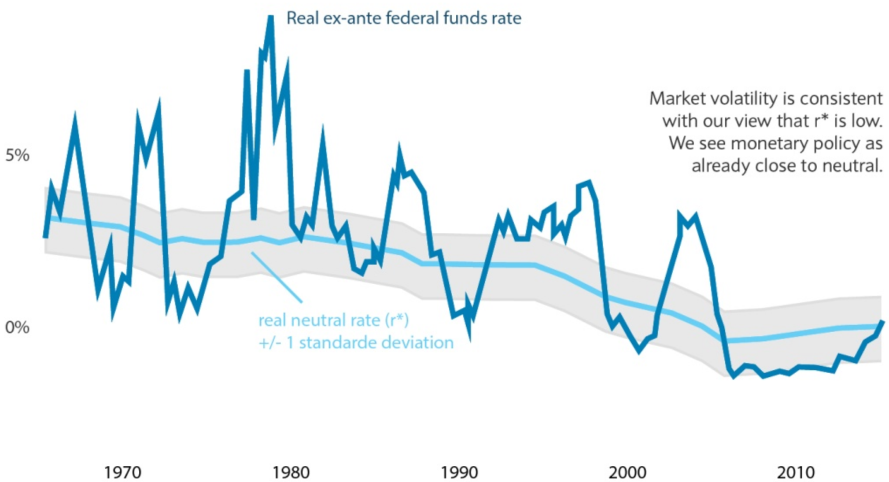
6 Another worrying sign: loan officers are tightening lending standards. If sustained, this could lead to higher corporate defaults.



Source: Federal Reserve, Moody's, Barclays Research

But the Fed response loosened global financial conditions…

7 Market volatility confirms our view: rates are close to neutral



8 The FOMC is therefore now more cautious about further hikes

Highlights from January FOMC meeting minutes:

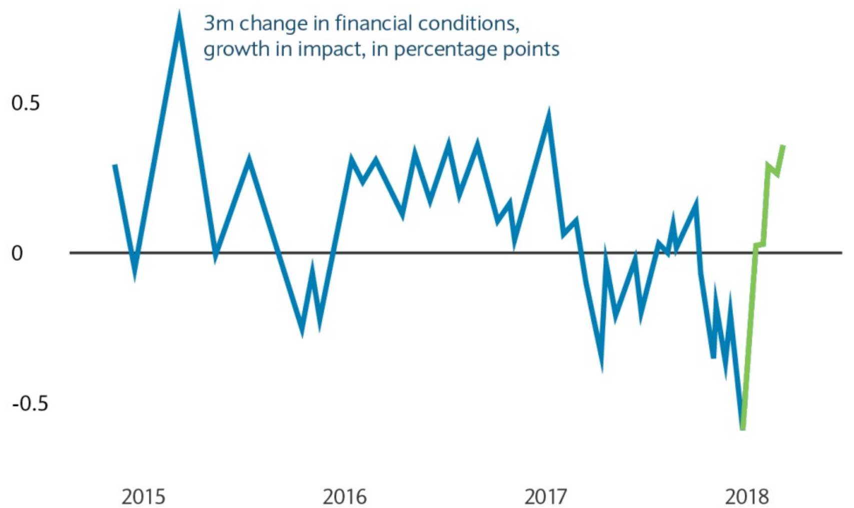
"Additional data would help policymakers gauge the trajectory of business and consumer sentiment, whether the recent softness in core and total inflation and inflation compensation would persist, and the effect of the tightening of financial conditions on aggregate demand".

"many participants suggested that it was not yet clear what adjustments to the target range for the federal funds rate may be appropriate later this year; several of these participants argued that rate increases might prove necessary only if inflation outcomes were higher than in their baseline outlook."

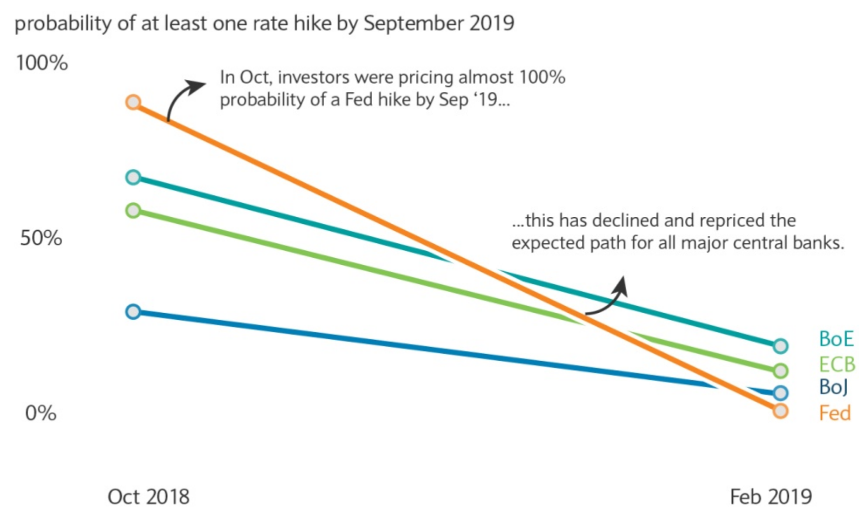
Several other participants indicated that, if the economy evolved as they expected, they would view it as appropriate to raise the target range for the federal funds rate later this year."

"many participants observed that if uncertainty abated, the Committee would need to reassess the characterization of monetary policy as 'patient' and might then use different statement language".

9 The result has been a sharp loosening in financial conditions…



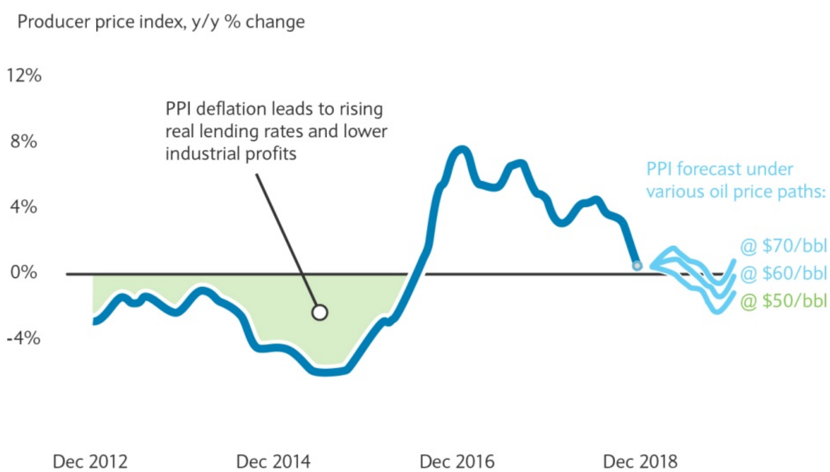
10 …and a reappraisal of the path for all major central banks



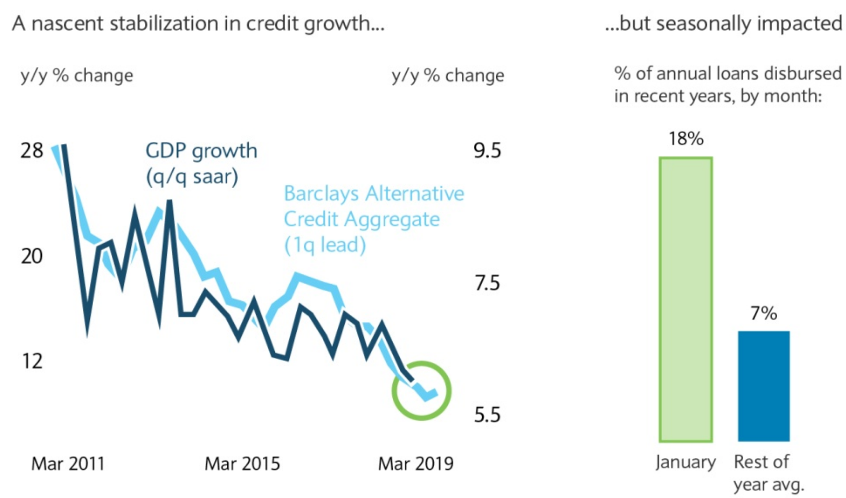
Source: Bloomberg, Federal Reserve, Barclays Research

…allowing China to stimulate with less risk of capital flight

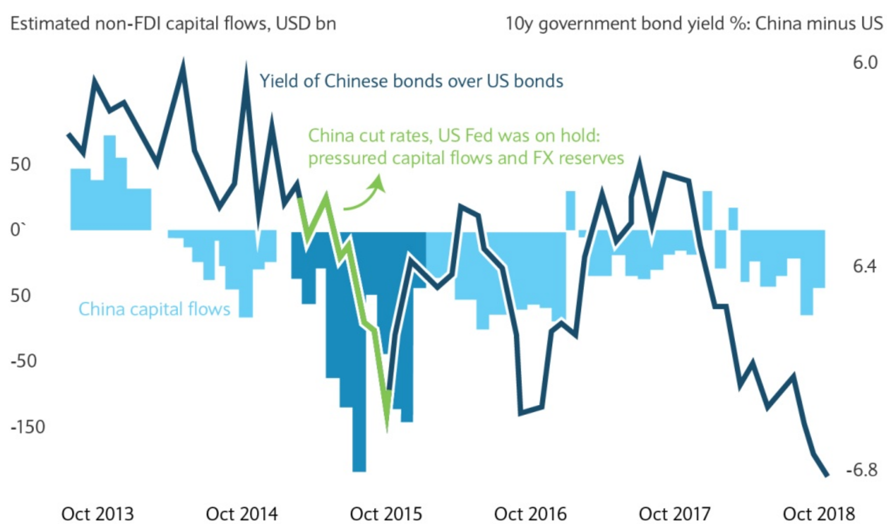
11 The drop in PPI is problematic for debt burdened China



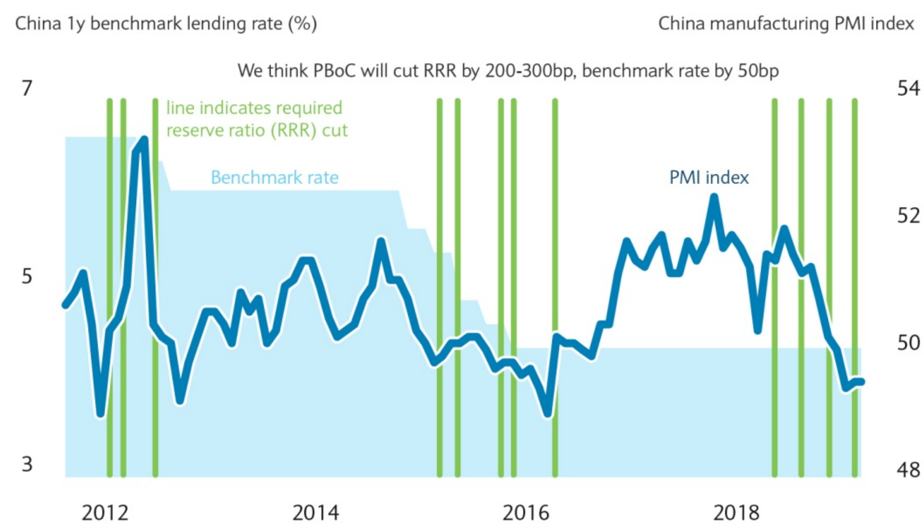
12 Credit surged, but driven by seasonal bank lending



13 Fed backing off allows China to cut without risking outflows…



14 …we think they will cut, as they have historically with weakness



Easier policy helps but can't justify the magnitude of the rally

15 A dislocation in bonds versus stocks makes sense...

16 ...but valuations may have run too far

The Fed may be inciting excessive risk-taking
The pause in hikes, potential earlier end to balance sheet runoff, and possible change in the framework risks fueling exhuberance.

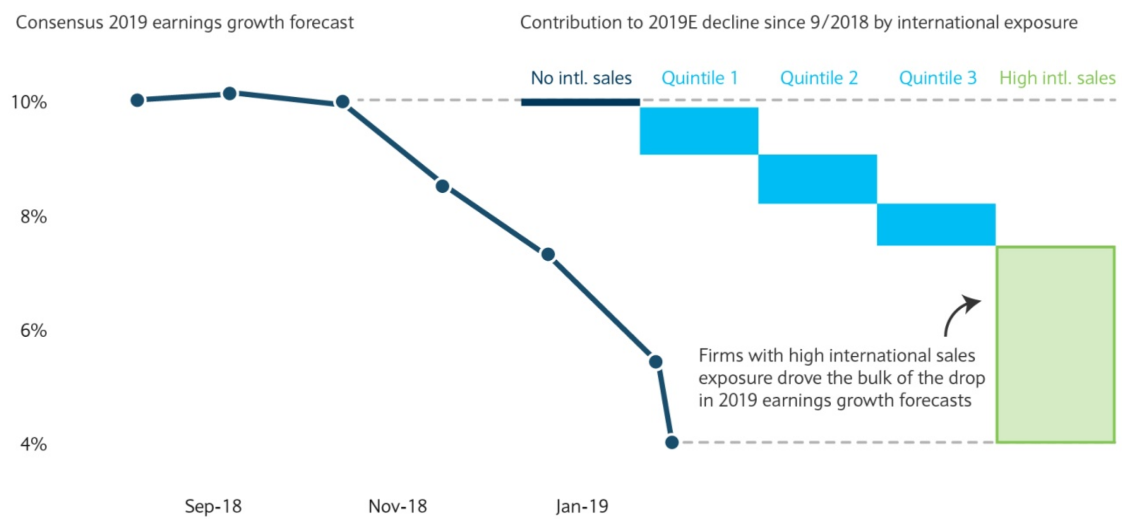
The reason for the shift from central banks is weaker data...
Investors shouldn't forget what's driving the change in policy stance: weaker data

...which is clearly showing up in lower earnings expectations...
internationally-oriented firms are driving the bulk of the decline

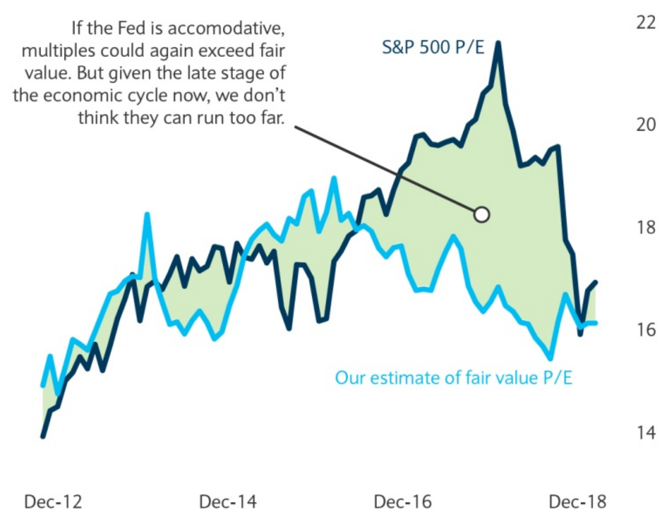
...the rally has therefore been driven by higher mutliples.
Multiples are again above our estimate of fair value.

This leaves investors with little protection against risks materializing.
In particular, the US-trade war: we expect a short-term deal that partially addresses merchandise trade and market access, but stops short of resolving the technology-related issues such as IP theft.

17 Analysts have slashed earnings forecasts, especially for globally exposed firms



18 Multiples offer little protection against risks



Source: Bloomberg, Federal Reserve, Barclays Research

Wrapping up

Thematic summary

The global economy continues to slow down

1. There have been twice as many disappointments as upside surprises.

Europe in particular disappointed, driven by Germany

2. We are tracking Q4 US GDP lower...
3. ...but the main source of disappointment has been Europe.
4. European growth has slowed since the end of 2017...
5. ...driven by Germany in particular

Bank lending standards are tightening in the US and Europe

6. Loan officers are tightening lending standards. This could lead to higher defaults.

But the Fed response loosened global financial conditions...

7. Market volatility confirms our view: rates are close to neutral
8. The FOMC is therefore now more cautious about further hikes
9. The result has been a sharp loosening in financial conditions...
10. ...and a reappraisal of the path for all major central banks

...allowing China to stimulate with less risk of capital flight

11. The drop in PPI is problematic for debt burdened China
12. Credit surged, but driven by seasonally bank lending
13. Fed backing off allows China to cut without risking outflows...
14. ...we think they will cut, as they have historically with weakness

Easier policy helps but can't justify the magnitude of the rally

15. A dislocation in bonds versus stocks makes sense...
16. ...but valuations may have run too far
17. Analysts have slashed earnings forecasts, especially for globally exposed firms
18. Multiples offer little protection against risks

Key takeaways

Data has continued to disappoint over the last month.
The Euro Area in particular looks extremely weak and even US data has been less than unequivocally positive.

The pickup in China credit growth in January was a welcome surprise.
But China is likely to provide less fiscal stimulus now than in the 2015-16 slowdown, and will depend more on monetary policy support.

The Fed moving decisively to the sidelines has helped loosen financial conditions and allows central banks like the PboC to ease more aggressively.

Risk assets have reacted very positively to this change in Fed stance, and are off to their best start in many years. However, they might now have turned a bit too optimistic.
After all, global central banks' shift to easing is not in isolation but in response to economic weakness.

Moreover, most of the binary risks - Brexit outcome, possible auto tariffs, US-China trade negotiations - are not yet resolved.
We recommend being long higher quality US fixed income over global equities, and expect bond markets to trade in a fairly tight range.

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